

104
THE U.S.-CHINA INTELLECTUAL PROPERTY
RIGHTS AGREEMENT: IMPLICATIONS FOR U.S.-
SINO COMMERCIAL RELATIONS

Y4.IN8/16:
C44/6

HEARING
BEFORE THE
SUBCOMMITTEES ON
INTERNATIONAL ECONOMIC POLICY AND TRADE
AND
ASIA AND THE PACIFIC
OF THE
COMMITTEE ON
INTERNATIONAL RELATIONS
HOUSE OF REPRESENTATIVES
ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

MARCH 2, 1995

Printed for the use of the Committee on International Relations



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THE U.S.-CHINA INTELLECTUAL PROPERTY RIGHTS AGREEMENT: IMPLICATIONS FOR U.S.-SINO COMMERCIAL RELATIONS

THURSDAY, MARCH 2, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY
AND TRADE, AND SUBCOMMITTEE ON ASIA AND THE
PACIFIC,

Washington, DC.

The subcommittees met, pursuant to call, at 2 p.m. in room 2172, Rayburn House Office Building, Hon. Doug Bereuter (chairman of the Subcommittee on Asia and the Pacific) presiding.

Mr. BEREUTER. The subcommittee will come to order. Today's hearing is the third joint hearing of the Subcommittees on Asia and the Pacific and International Economic Policy and Trade of the 104th Congress. On February 9, 1995, as chairman of the Subcommittee on Asia and the Pacific, I stated three fundamental principles or goals which I felt should be the basis for the subcommittee's agenda.

One of those was that the United States must better focus and augment its resources to defend our economic interests, to expand our commercial opportunities, and to ensure American competitiveness in the region.

Last Sunday, Ambassador Mickey Kantor announced that the United States had successfully completed a comprehensive agreement with China on that country's commitment to enforce its intellectual property laws. It has been estimated that China's failure to protect U.S. intellectual property rights has cost U.S. companies over \$1 billion annually.

Just 2 days before Ambassador Kantor's announcement that the special 301 trade sanctions would be suspended, Secretary of Energy Hazel O'Leary announced that the United States and China had signed commercial contracts totaling \$4.6 billion on energy development in that country.

Although conflicting messages from the administration had previously caused China to firmly rebuke our demands, these two developments have conversely underscored the value of firmness in the promotion of U.S. trade interests. The likelihood of sanctions in this case did not cause Beijing to retaliate against U.S. interests. Instead, it forced the Chinese to make a strategic choice in the direction of maintaining a valued economic relationship with the United States. Whether this outcome validates the administration's

comprehensive engagement strategy toward China remains arguable, because the U.S. Government has not exercised similar degrees of firmness in all situations and because the United States does not always enjoy the same degree of leverage.

Nevertheless, this positive outcome provides on one hand, a very detailed and measurable agreement on intellectual property rights, and on the other hand, important agreements for the U.S. investors in the region. These simultaneous actions represent a constant dilemma for U.S. foreign commercial policy with China.

When is it appropriate to persuade China with sanctions and when is it appropriate to persuade China with rewards? And, can economic leverage serve political objectives? Although the IPR Agreement represents a substantial improvement in U.S.-China commercial relations, at least we believe it does, several commercial and foreign policy issues remain to be addressed. There can be no doubt that there will be disagreement on which method to employ.

For example, the IPR Agreement could be seen as a possible boost to the now stagnant negotiations over China's accession to the World Trade Organization since the terms of that accession will largely be determined by the United States and its allies. Similarly, human rights advocates have already alluded to the IPR Agreement as an example of what the United States can accomplish with a unified and coherent policy.

This argument is likely to be a part of the annual Most-Favored-Nation or nondiscriminatory trade status debate. Meanwhile, U.S. business interests have indicated that the United States should re-examine U.S. commercial relations and sanctions, such as the prohibition on the U.S. export promotion agencies from operating in China, and remaining Jackson-Vanik provisions which would prohibit the United States from fully recognizing China's accession to the World Trade Organization when the accession occurs.

Obviously, policymakers may disagree on whether to use sanctions or rewards in each of these important foreign policy issues. Nevertheless, it seems to me that it is important that we ask the following basic questions before we arrive at conclusions to these questions.

One—how important is the issue to U.S. interest? Two—how does the issue relate to broader U.S. strategic interests in China? Three—how much leverage does the United States have over the PRC on the particular dispute? Four—does the United States enjoy the support of its allies and friends? And, five—how sensitive is the issue to the PRC and to those contenders for political power in the post-Deng Xiaoping era; what is likely to be their reactions?

Today, we are extremely fortunate to have the Honorable Charlene Barshefsky, Deputy U.S. Trade Representative and a lead negotiator in the U.S.-Sino IPR Agreement, and the Acting Assistant Secretary for East Asian and Pacific Affairs, the Honorable Peter Tomsen, to discuss both the details of the Intellectual Property Rights Agreement and its implications for future bilateral commercial relations.

Ms. Barshefsky has just returned from these important and rigorous IPR negotiations. We are grateful that she could testify so soon after her return. Indeed, it is already her second appearance

before the Subcommittee on Asia and the Pacific this year. Similarly, we are fortunate to have Assistant Secretary Tomsen's broad perspective on these important issues in light of the many years of experience he has on Chinese affairs, both in the Department and as deputy chief of mission at our embassy in Beijing.

After our first panel, we look forward to hearing from two distinguished private sector witnesses—the Honorable Beau Boulter, former Congressman from Texas, a friend of ours and author of the article, "President Clinton's China Policy: From Human Rights to the Bottom Line"; and Doctor Robert Kapp, president of the U.S.-China Business Council, who has been widely quoted in the last few days as a result of the IPR Agreement. The U.S.-China Business Council represents more than 280 American corporations with substantial trade investment interest in China.

Before we begin with the witnesses, I would like to turn first to my distinguished colleague from California, the ranking member of the Subcommittee on Asia and the Pacific, Mr. Berman, for any comments he might like to make.

[The prepared statement of Mr. Bereuter appears in the appendix.]

Mr. BERMAN. Well, thank you very much, Mr. Chairman. And let me begin by thanking you once again for organizing a very timely hearing on extremely short notice. The ink is hardly dry on the agreement, and thanks also to Deputy Representative Barshefsky and to Deputy Assistant Secretary Tomsen for your time.

This has been a busy week in the U.S.-China relationship, one capping negotiations which began a year and a half ago. And I join a good number of people in the government and the private sector on congratulating you on having prevailed through some difficult stretches. The costs of intellectual piracy are difficult to overstate. They not only mar what has become a \$50 billion commercial relationship with China, but cut deeply into U.S. exports throughout Asia and South America, where illegally copied software and entertainment products are routinely sold.

Most observers agree that after so many fruitless rounds of discussion with the Chinese, the agreement represents a genuine breakthrough. You probably know all too well, however, that there is a great deal more work to be done. The deal struck with China late last week is but a schematic for a dramatic transformation. China's leadership needs to effect its information sector. Whether they are inclined to do so and whether they are able to do so are two questions that cut to the heart of our relationship with that country.

Some have doubted China's ability to rein in a booming illegal industry which ties government officials to underworld entrepreneurs. Nevertheless, by maintaining a consistent negotiating position, backed by the threat of a disruption of trade, we have managed to focus the attention of Chinese leaders and commit concerted energy to greatly needed administrative and legal reforms. It is obvious that sticking to our guns worked in this case.

Early on, we defined our objectives, made them clear to our Chinese counterparts, and outlined clearly the consequences of their failure to undertake measures to end intellectual piracy. Now, I wish that we could rivet their attention in the same fashion to

areas that are of equal or even greater concern. For example, it seems that no matter how we adapt our approach to human rights and weapons proliferation, Chinese rights violations and exports of troubling military technology continue.

There is no reason why we can't keep our dialogue with the Chinese on these issues in terms that are as clear and as simple as our discussion of intellectual property rights. After all, we aren't asking for things such as special enforcement periods, task forces or customs mechanisms, as in the case of the intellectual property agreement. But simply for the Government of China to cease and desist from certain abhorrent or destabilizing activities.

Successful engagement with China on these issues, no doubt, will require some of the same skill and consistency we have applied to the intellectual piracy negotiations. So I look forward to the hearing, Mr. Chairman, the assessments of the agreement today from our witnesses, and to exploring that agreement's usefulness as a model for resolving other outstanding issues in our relations with China.

I think your questions that you propounded here are worth considering and very clearly shape the—put together a frame of reference for us to look into those issues. And I thank you.

[The prepared statement of Mr. Berman appears in the appendix.]

Mr. BEREUTER. Thank you very much, Mr. Berman, for your outstanding statement. I now turn to the distinguished gentleman from Wisconsin, Mr. Roth, the chairman of the Subcommittee on International Economic Policy and Trade for his comments.

Mr. ROTH. Thank you, Mr. Chairman. It is nice to have our two subcommittees meet again on this very important topic. Let me join in—join you in welcoming our witnesses to this joint hearing, protecting our intellectual property, essential to our competitive strength and our global markets and to defend our economic security.

Asia is the most important battleground. For years fruits of American technology, skill and knowledge, as I see it, have been stolen by our Asian competitors, often with the or in collusion with their governments.

As China begins to move toward a market economy, intellectual property piracy has mushroomed. We want China to embrace market forces, but to enter the global marketplace they, too, must observe the rules. In these negotiations, we draw the line and I think we stuck to our views.

Now, we see the results of maintaining our national resolve. I am pleased with the very positive agreement just achieved in this agreement, but I think enforcement is vital. And with any kind of agreement you have, if it is not enforced, it is worthless. So today we will receive testimony on how the administration intends to ensure full implementation and enforcement.

I think if we make agreements, no matter how good they might be on paper, if we don't enforce them, we just, I think, lose in the eyes of whoever we are dealing with. And so I think enforcement is extremely important. I know China is a very important trading partner in the world. They have one-fifth of the world's population. So we welcome their entry into the international marketplace, but

I think we have to make sure that we insist on our rights being protected.

With that, Mr. Chairman, I appreciate, again, having this joint hearing between our two subcommittees.

Mr. BEREUTER. Thank you, Chairman Roth, for your excellent statement. And it is a good cooperative relationship. I turn now to the distinguished gentleman from Connecticut, the ranking democrat on the Subcommittee on International Economic Policy and Trade for any opening statement he might have.

Mr. GEJDENSON. Thank you, Mr. Chairman. And I want to join my colleagues in commending you and Chairman Roth for holding this hearing, and commend the administration for the work they have done.

There are a lot of fans here for the effort, particularly for what Ms. Barshefsky has done here, and other places. And we hope we have learned some things in this process as well as in the country, and I think that—I remember we had a hearing about a year ago, and we had a copy of the Jurassic Park CD before it was available in the United States, with Chinese subtitles, and excellent quality, I must say.

We took it home and looked at it. And it was—what was inspiring was in the lower left-hand corner was the disclaimer stating that it was illegal to reproduce or in any way show those things in violation of certain regulations and agreements that the United States held to. And it always struck me that a country that had the sophisticated act to make that kind of reproduction should have the sophistication and ability to follow its agreements.

And for our country, I think the lesson is that when we come to agreements, as we had in the past with the Chinese and others, and we haven't had just this problem just with China, we have had similar problems in other countries, in Japan is a good example, is that we need to do the enforcement mechanism in the same agreement. Because it is clear, if you look at the Japanese chip agreements through the years and other programs, that unless there is some enforcement mechanism, the great statements at the end of the negotiations tend to evaporate after the agreement has been signed. And clearly the kinds of things we did last year in providing assistance through AID, and as you have done in this agreement, make sure that we provide the technical ability to achieve these agreements. Because all of us need to make sure that we are vigilant on intellectual property. It seems often the most harmless of theft to people.

Consumers in this country and elsewhere, you know, they don't feel like they are stealing your car or grabbing your briefcase when they buy knock-offs of either products or intellectual property. But it does steal people's hard-earned efforts and their potential profits. I hope that as a country, and I think this administration has been spectacular in these trade issues, as you have done a great job here, that we won't forget human rights and nonproliferation as well.

We need to be tough negotiators in other areas of international concern. And for the Chinese, this is a checkoff point. Are they willing to live with international agreements that they have reached? This is now stage two in this one. There is a standard of behavior

in commerce. There is also a standard of behavior in human rights that goes beyond a country's own borders and issues of non-proliferation, and while they are not the heart of this meeting and I want to commend, again, the administration for their work in this meeting, it is something that we as a nation have to keep focused on.

In the past, this country would often look the other way if it were right wing governments who pledged their fidelity against communism, when it came to human rights. If the government was conservative enough and ready to resist communism enough, we would ignore their human rights violations.

I don't want to see an America where when the trade advantages are sufficient, we look the other way on human rights. They are separate issues, they are separate issues that need to be addressed, though, and not given just simply in favor of the other. And, again, I commend the chairmen of the subcommittees for holding this hearing.

Mr. BEREUTER. Thank you very much, Mr. Gejdenson, for your comments. Without objection, all members may submit opening statements that they may have for the record.

Are there any other members who would like to be recognized for an oral statement at this point? Thank you very much. We do have two panels, we want to allow maximum time for not only their presentation, but for questioning. Ms. Barshefsky, please proceed, unless you reached another arrangement.

STATEMENT OF HON. CHARLENE BARSHEFSKY, DEPUTY U.S. TRADE REPRESENTATIVE, OFFICE OF THE U.S. TRADE REPRESENTATIVE

Ms. BARSHEFSKY. No, that is fine, thank you very much. Thank you, Messrs. Chairmen, and members of the subcommittees. It is a pleasure to be back here before you again. And I ask, sirs, that my full remarks be accepted into the record.

Mr. BEREUTER. That will be the case.

Ms. BARSHEFSKY. I would like to bring you up to date on the recent agreement that we have concluded with China with respect to intellectual property rights enforcement. Our computer software, motion picture, sound recording, publishing and other industries, will also benefit in this agreement from new and expanded market access in China.

May I say, though, before I begin, that this administration is very appreciative for the support that we have received from these subcommittees as we negotiated with China. I would suggest, Mr. Chairman, that among your very good questions that you asked in your opening remarks, is the question how unified is U.S. support behind a particular issue. And on this issue, there was unified, unwavering support on the part of these subcommittees, on the part of the U.S. business community, and on the part of the Congress as a whole. And this made an enormous difference to us during the course of the negotiation.

Let me also say before I begin that Ambassador Kantor has been invited by the Chinese leadership to travel to Beijing. He intends to do that this month to continue to build a serious and reciprocal trade relationship with the Chinese. The first step he will take will

be formally to launch this IPR Agreement. And if I may now, let me turn to review for you briefly the key elements of the agreement.

The agreement has two aspects. There is an IPR enforcement aspect and there is a market access aspect. Let me take you through each one. With respect to intellectual property rights enforcement, China has agreed to establish a comprehensive enforcement structure that will permit effective action against piracy throughout the country. This structure includes intellectual property working conferences at the central and subcentral levels, and enforcement task forces.

All agencies charged with enforcement, including the police and customs, will participate in raids and other enforcement activities. Although the enforcement task forces will be in place over the long term, China will intensify efforts over the next 6 months to eradicate piracy and counterfeiting. This will be done under the auspices of what we call a special enforcement period, of the type we have used very successfully in many countries around the world, including Korea and Italy.

This period will be marked by significant and sustained raids at the retail, distribution and producer level. The export of infringing goods is banned, and both customs and the enforcement task forces have the authority to seize and destroy infringing products and to seize and destroy the material and implements used to manufacture these infringing products.

The enforcement task forces will also collectively have the authority to investigate, to preserve evidence for litigation, to order infringers to stop their activity before litigation, and once infringement is found, they will have the authority to levy fines, to put in place permanent injunctions, to require the payment of compensation, to require the forfeiture and destruction of goods, to revoke business licenses and operating permits of producers.

Customs will also establish a copyright and trademark recordation system, based on the U.S. custom system, to monitor exports and imports of products from China.

In addition, China will implement special plans in the audio-visual sector that would include sound recordings and motion pictures, in the computer software sector, and in the book publishing sectors, and in addition, China will devote more resources to the enforcement of trademark rights.

In the audio-visual sector, for example, China is now implementing a detailed system of permits and business licenses that will ensure that Chinese companies have permission of right holders to engage in reproduction, distribution and other activity in China.

Unless permission has been received and business permits and licenses are provided, authority to operate plants will be revoked. Representative offices of U.S. associations in the copyright area will be permitted to open in China and these offices will work with Chinese officials to verify copyright.

By July 1 of this year, all factories producing CD's, LD's and CD-ROM's will be investigated to ensure that each factory has copyright authorization to reproduce sound recordings, motion pictures and computer software. Each firm will use a unique identifier so that customs and other enforcement authorities will know where

particular CD's, LD's and CD-ROM's are produced, and can then take action against the infringing factory.

The special plan for computer software requires retail outlets of software to maintain an inventory, including information on the type, quantity, origin and product location of any software that it commercially reproduces, distributes or rents. This information will be verified and retailers acting without an appropriate business license or dealing with unauthorized product will have that product seized and destroyed. Repeat offenders will lose their business licenses and will not be issued another license for a period of 3 years.

In addition, customs will prevent the import and export of pirated software and audiovisual products through the use of a verification system. China has already taken some action to improve enforcement. As we indicated, when we were in Beijing, we have confirmed that seven CD factories have been inspected and closed, and over 2 million infringing CD's and computer software have been destroyed.

This is a good beginning, but much more is required under the agreement. The United States intends to consult closely with China on implementation and the United States will provide technical assistance in the implementation of this agreement to ensure that the commitments China has made can be carried out.

With respect to the second aspect of the agreement, and that is market access, the U.S. sound recording, motion picture and software industries will benefit from significantly improved market access in China. Legitimate product will now be able to be imported or manufactured to replace the pirated product.

China, first of all, will not impose quotas, import licensing requirements or other noncensorship restrictions on the import of audiovisual published products, whether formal or informal. In the audiovisual sector, China will permit U.S. firms to establish joint ventures with Chinese firms in China for production and reproduction of product. These joint ventures will be permitted to enter into contracts with Chinese publishing enterprises to, on a nationwide basis, distribute, sell, display and perform these products.

China will immediately permit establishment of these joint ventures in Shanghai, Guangzhou, and other major cities, and, in addition, will then expand the number of these cities to 13 by the year 2000. U.S. sound recording firms will be permitted also to enter into exclusive licensing arrangements with Chinese publishing houses to exploit their entire catalogs and to decide what to release from that catalog.

U.S. firms will be able to enter into revenue-sharing arrangements with Chinese firms, including in the case of films, licensing arrangements that permit U.S. companies to share in a percentage of the gross revenue achieved by a work, rather than a flat fee.

Joint ventures will also be permitted in computer software. These ventures can produce and sell their computer software products throughout China. Censorship requirements will be published and decisions on whether requirements are met will be made quickly. Regulations will be open, transparent.

Finally, Mr. Chairman, U.S. companies have been specifically invited by the Chinese to begin as soon as possible discussions on

their commercial establishment in China. Messrs. Chairmen, this is a good agreement for U.S. workers and firms. It will bolster our efforts to create more high wage jobs in some of our most competitive industries.

Our legitimate high quality products will not be required to compete against Chinese pirated and counterfeit goods in China and in third-country markets.

Our exports to China and third countries should increase. It means American business can gain the confidence. They will be fairly treated as they enter the Chinese market, one which presents immense potential for us. This is also a good agreement for the Chinese.

Full implementation will provide evidence that China is willing to play by international rules and enforce the commitments it makes. The agreement contains key features ensuring transparency, the rule of law, and judicial improvements, all of which help bolster efforts toward a more open and internationally competitive—compatible regime. We cannot rest on this agreement alone, however.

There is no question that what matters now is implementation by the Chinese and enforcement by the United States. We intend to watch very, very closely to ensure that the commitments made are lived up to, and we intend to continue to press China very vigorously to demonstrate the necessary political will to begin to enter the international community on a commercially reasonable basis.

Again, let me say that I appreciate very greatly the support of the subcommittees and the cooperation we have received from you as we have gone through these very arduous negotiations. If I might also say, Messrs. Chairmen and members of the committee, although I am the one speaking here and getting some of the credit, there are many, many people who helped negotiate this arrangement. And if I may mention in particular from our office, Lee Sands, Deborah Lehr, Catherine Field and Tom Robertson, who have spent the last 20 months, most of which has been in Beijing, working toward achievement of this agreement. Thank you very much.

[The prepared statement of Ms. Barshefsky appears in the appendix.]

Mr. BEREUTER. Ambassador Barshefsky, please convey our appreciation to the staff that has worked so hard for the USTR and other agencies in this respect. I do think you are absolutely right that the solid front from the U.S. Government, certainly including the Congress in this respect, was important and that you have not overstated it. It was a position that was easy to take on a bipartisan basis.

Secretary Tomsen, welcome to the subcommittees. We look forward to your testimony. You may proceed as you wish.

STATEMENT OF HON. PETER TOMSEN, ACTING ASSISTANT SECRETARY OF STATE FOR EAST ASIAN AND PACIFIC AFFAIRS, DEPARTMENT OF STATE

Mr. TOMSEN. Thank you, Mr. Chairman, and thank you for the opportunity to speak before the Subcommittee on Asia and the Pa-

cific of the House Committee on International Relations, now known as HIRC.

Mr. BEREUTER. Mr. Secretary, would you pull that a little closer?

Mr. TOMSEN. Can you hear me now?

Mr. BEREUTER. That is better. Perhaps a little closer.

Mr. TOMSEN. Mr. Chairman, thank you for the opportunity to speak before the Subcommittee on Asia and the Pacific of the House Committee on International Relations, and the Subcommittee on International Relations Economic Policy and Trade. I, too, ask that this statement be included in the record.

Mr. BEREUTER. That will be the order.

Mr. TOMSEN. Thank you.

First, I would like to extend my personal congratulations to Ambassador Barshefsky and her entire interagency team for the successful conclusion of the IPR negotiations. I am pleased to have this opportunity to sketch out in broad terms how the IPR Agreement fits into the administration's overall strategy of comprehensive engagement with China. This is a diverse and complex relationship.

Since we established formal diplomatic relations with the People's Republic of China in 1979, our relationship with China has become increasingly diverse and complex. The IPR negotiations are only the most recent demonstration of the numerous and complex issues we deal with in this relationship.

In this, as in other areas, pursuing the interests of the United States is, of course, the fundamental premise of our China policy. We use this benchmark in addressing the entire constellation of bilateral, regional and global concerns in which Sino-American interests intersect.

What, in short, will produce the most effective results? Let me say a few words about the President's comprehensive engagement strategy, which you referred to in your opening remarks, Mr. Chairman. Achieving U.S. interests in economic, political, security, human rights and other areas is a goal of this administration's strategy of comprehensive engagement with China.

Simply stated, the purpose of this policy is to pursue all of our interests at the levels and intensities required to achieve results, to seek to build mutual confidence and agreement in areas where our interests converge, and through dialogue reduce the areas in which we have differences, and try to make as much progress as possible.

There are those who contend with conviction that if China fails to address our concerns on one particular issue, then we should put our other interests and objectives on hold until we have seen progress in that area. We understand and fully respect these views. However, this administration believes that in dealing with a country as large and as important as China, it is essential to continue pushing our interests forward on as many fronts as possible.

A brief word on human rights. Quite naturally, our attention is often and also focused on the human rights issue. When the President decided last year to delink human rights from MFN, he made it clear that delinkage represented a shift in the tools we will employ to achieve progress on China human rights issues. This did not represent a shift from our continued stress on human rights.

Improvement in Chinese human rights practices is an essential element of our China policy and, indeed, of our efforts to achieve a stable long-term U.S.-Chinese bilateral relationship.

What are our broad goals in economics and trade? Our increasing important economic and trade relations with China are another key aspect of the comprehensive engagement strategy. In this area, our strategy has two basic elements.

First, we seek to fully integrate China into the global market-based economic and trading system. Our bilateral and multilateral efforts to open China's economy fall into this category.

Second, we seek to expand U.S. exporters' access to the Chinese market. Clearly, the IPR Agreement contributes directly to our efforts to develop commercial opportunities for U.S. firms in China and elsewhere. Its reliance on enforcing the rule of law in China also fits into our human rights strategy.

The IPR Agreement demonstrated that when all sides are determined to seek mutually acceptable solutions through serious and detailed talks, agreement is always possible. We hope that this pattern will be applied with equal success in China's WTO accession process and in other aspects of our bilateral relations.

We also continue to expand our export promotion efforts, one of the central responsibilities of what Secretary Christopher has referred to as our America desk. This was a central focus of Secretary O'Leary's recent visit to Beijing, and, of course, of Secretary Brown's trip there last August.

Mr. Chairman, China is a large, populous, militarily powerful and economically significant country, whose influence in the world cannot but increase in the decades ahead. Managing this complex relationship will require sophistication, patience and much hard work. There will be no quick fixes as we go along this path.

We believe that the President's strategy of comprehensive engagement is the best way of furthering the broad range of U.S. interests in China and East Asia. We hope that our approach will enjoy broad bipartisan support of the Congress. Thank you, sir.

[The prepared statement of Mr. Tomsen appears in the appendix.]

Mr. BEREUTER. Thank you very much, Mr. Secretary. We will now move to the normal questioning period, and we will operate under the 5-minute rule. I will try to recognize members after the chairman and ranking members in order of appearance.

I suspect we will have time really for only one panel so we do not short the second panel. So, think of that as you frame your questions. I call first on Chairman Roth for the question period.

Mr. ROTH. Madam Ambassador, are you confident that the Chinese National Government has the ability to enforce the agreement?

Ms. BARSHEFSKY. I am completely confident the Chinese Government has the ability to enforce the agreement.

Mr. ROTH. How about the will?

Ms. BARSHEFSKY. I think we will always have to test the will. I think right now the will is there. I think the predicate to that agreement, which was the closing of some of the CD factories, particularly Shenfei, which is the most notorious of these factories

since it is the largest, demonstrates that at the current time the political will is there.

We need to ensure that that will remain there through a combination of vigilance on our part, technical assistance on our part, putting some people on the ground on our part, and having—letting China know that we intend to keep the pressure up until piracy is fully resolved.

Mr. ROTH. Well, you know, it seems that in all of these former Communist countries, as they move from communism toward a more free enterprise system, it seems like the Mafia moves in as the central government breaks down. And I was told by some of the people that were visiting in my office that the government officials in China facilitate the pirating. They are involved to some degree. Do you think that is true?

Ms. BARSHEFSKY. Yes. There is no question—

Mr. ROTH. Then have you got the enforcers profiting from some of the pirating.

Ms. BARSHEFSKY. Well, let me say, we see this in many countries, not just in China. We have seen this in many countries in Asia. We have seen the same pattern in many countries in Latin America. And yet in many of these same countries, we have been able to eradicate piracy, in part because countries come to realize vigorous enforcement is necessary if investment flows are going to continue. And in part, eradicated through market access for U.S. companies.

Once U.S. companies get in the market and begin controlling many of these factories, what foreign countries find is they make more money than they had made as pirates, and the work that comes out of the factories is legitimate and so they have international acceptance. So it ends up being a win/win situation. None of this happens overnight, but we have seen in a number of countries that over the course of several years piracy is substantially eliminated.

Mr. ROTH. What country could we point to and say this is sort of a model country in that respect?

Ms. BARSHEFSKY. Well, we think we have done very well. I will give you one example, with Korea, which had been one of the chief pirates in Asia, in which we created a special enforcement period, gave the Koreans technical expertise, some of our companies have greater market access in Korea, and we have seen a vast diminution in piracy in Korea. Italy is another example. There are a number of examples that we can cite to where we have seen pretty significant improvement.

Mr. ROTH. OK. Thank you.

Mr. BEREUTER. Thank you very much. Mr. Berman.

Mr. BERMAN. Secretary Tomsen in the last couple of weeks or 10 days or so I read that there has been a recent, very public and, I imagine, very courageous series of public actions by human rights supporters, academics, others in China, public petitions to the government, open criticisms.

Have you been following this and what the Chinese reaction has been? Do you have any sense of why all of a sudden this is now occurring and where it might go?

Mr. TOMSEN. Yes. Every year before the National Peoples Congress opens in Beijing, usually in March, you have had this type of activity, which is petitioning the NPC, the National Peoples Congress, and also other bodies, through letters and petitions that are also given to the Western as well as the Chinese press. This is done by prominent Chinese dissidents, sometimes whole groups.

In one occasion here, there were 25 involved. This year it has picked up. The tempo is more intensive and there is more petitioning. Wong Dung, who was initiator of a petition last year, was jailed for the entire NPC session. This year, he distributed another petition and was picked up for 30 minutes and then released. I guess you could say this is an improvement, but we condemn any move like this to detain somebody for expressing his political views.

As Wong Dung and others have pointed out in China, such petitioning of the government is allowed under the Chinese constitution and is also allowed under Chinese law. I might mention, it is also allowed under the Universal Declaration of Human Rights, to which China ascribes. And we see no reason why he had to be detained or any steps have to be taken against him or others who are merely practicing rights that they enjoy as Chinese citizens under Chinese law.

Mr. BERMAN. Well, Mr. Chairman, I don't—I was here mostly to hear about the agreement and learn more detail. I think it was a great achievement and I don't have any more questions at this time.

Mr. BEREUTER. Thank you very much.

Ambassador Barshefsky, earlier you testified before our subcommittee that the Chinese Government was actually using stolen U.S. computer software. How does the agreement address that particular infringement?

The *Journal of Commerce*, for example, reports that this particular issue was, "glossed over," in the Accord, and the *New York Times* reports that the USTR dropped its initial demand that the U.S. software be paid for. Is that accurate? If so, how do you account for that action?

Ms. BARSHEFSKY. The United States had never asked for compensation because the industry was most concerned about prospective relief. That is a cessation to the use of infringing software, number one, and we have a commitment from the Chinese Government that there will be a cessation of use. But even more importantly, a commitment on the part of the Chinese Government that adequate budget will be provided to ministries for the purchase of legitimate software.

Until now, there has been no budget for the purchase of legitimate software by ministries. These were two very important elements to our software industry, and this is what the agreement achieves. There are also, as I have pointed out in my testimony, a variety of special provisions that apply to computer software and to special enforcement programs with respect to computer software.

Mr. BEREUTER. Would you think this action, then, with respect to the ministries is prospective only?

Ms. BARSHEFSKY. It is prospective essentially. There was a strong feeling on the part of those who were expert in this area that it would be very difficult to verify, since software is often—

often gets on a hard drive, very difficult to verify the actual stripping out of infringing software, but very easy to verify legitimate software purchases and budgeted line items for legitimate software purchases. Also easy to set up a system whereby those from whom the government procures have to be licensed as retailing and selling and distributing only legitimate software. So we went after the items we thought we could verify, and that would assure that only legitimate software would be used in the future.

Mr. BEREUTER. Thank you. I have one more question for either or both of you. What was the role of the Chinese leadership, such as the President or Li Peng, in the favorable outcome of the IPR talks?

How has this episode affected our assessment of the political transition in Beijing? Is there any evidence that Deng Xiaoping played any role in the negotiations, or his daughter?

Ms. BARSHEFSKY. I find that a very difficult question to answer. Ultimately, the Chinese decided that doing this agreement was in their interest. How that decision came to be made, the precise factors that entered into that decision, whether simply commercial, because commercially the agreement absolutely makes sense for China, or political, because politically the agreement also makes sense for China, or other factors, including international acceptability, what those specific factors were, I can't tell you.

I suspect they all came into play in the decisionmaking, including a desire for a turning point in the U.S. relationship and the start of a more stable relationship with the United States. But who made the call or—and precisely on what grounds that call was made, I can't tell you.

Mr. TOMSEN. I would just add that it was certainly a decision made by the politburo, and approved by the President of China, who is also the head of the Communist Party. It is hard to say whether Deng Xiaoping put his imprimatur on it, but all of the factors that Charlene mentioned certainly went into it.

Mr. BEREUTER. Thank you very much.

The gentleman from Connecticut, Mr. Gejdenson.

Mr. GEJDENSON. Thank you. Let me go to the next step to some degree and the World Trade Organization. And there are a number of complications here, obviously. There seems to be some general agreement that Taiwan would follow a Chinese entry into the World Trade Organization, or at least that is my sense that that is a doable program.

What about China entering the World Trade Organization? I mean do we—does it make sense now to sit back and watch this agreement for a while and say let's see how serious you are about living under the laws that—the agreements that you signed? And then what are the obstacles?

I mean a lot of China's economy is now a market economy, but there is still a fair amount of government activity there. It is always hard for me to figure out exactly how you integrate economies like China's into a primarily free market world economy.

Is there a time line, do you sense, and what are the biggest challenges?

Ms. BARSHEFSKY. There is no time line from the point of view of the United States. There is no question but that this administra-

tion believes that China's accession to the WTO is important and desirable. But only, only, on the basis of a commercially acceptable protocol of accession.

If we look at what that package would need to look at, you have, first of all, a series of core obligations that China would need to make up front, transparency in its trading regime, the uniform application throughout the country of its trade rules, not using its system of foreign exchange as a disguised barrier to trade, and other such basic GATT obligations.

Those are obligations to which all countries adhere, whatever the level of development. That is critical. Then you have a whole second tier of rules, on safeguards, on consultations, on subsidies, and State trading enterprises, the full range of additional GATT rules to which China would need to adhere.

Some of those may be able to be phased in, some not. But they have to be looked at individually, provision-by-provision, to see what seems to suit best and to see what will still provide a commercially acceptable basis for acceding. And then you have the key schedules on market access, for goods, for services, for agriculture.

Those have to be real commitments, with real timeframes, and significant, significant reductions in market access barriers. So we have a tremendous amount of work to do with respect to China's accession. We have told the Chinese that we are ready and willing to work with them on their accession package.

We worked very hard with them last year, but ultimately China did not reach its self-imposed deadline of accession by December 31, 1994, because its offers were absolutely inadequate.

At December 31, 1994, there was no major trading partner which wanted to see China to accede to the WTO because its offers were so poor. So we need to see if we are going to have talks, a seriousness about China's intentions, and then the appropriate range of commitments.

Mr. GEJDENSON. What are the biggest advantages to the United States of China joining the World Trade Organization and what are the biggest advantages to China?

Mr. BARSHEFSKY. Biggest advantages to the United States, on the basis that the protocol is commercially acceptable, is market access, playing by the rules. I would say those are the biggest, bringing China into the international community. Biggest advantages to China are international political acceptability, a cementing of its reforms and a structuring of its future reforms and dispute settlement.

Mr. GEJDENSON. And would it help us in a situation, for instance, in satellites, which there seems to be the Chinese taking a big chunk, we assume by subsidizing the program?

Ms. BARSHEFSKY. Certainly. Subsidies is one of the key areas that would have to be addressed in any agreement.

Mr. BEREUTER. Secretary Tomsen, do you wish to comment further on the questions?

Mr. TOMSEN. Yes, thank you, Mr. Chairman. Within the Chinese economy, in answer to your question, there are—there would be disadvantages also for China. There are whole sectors of the Chinese economy who benefit from protectionism. The State-owned enterprises sector, for instance, it has fallen from 80 percent 10 years

ago to less than 50 percent now, as privatization has come forward. But they are still a very important part of the economy and during a period of succession the State-owned enterprises have important political connections to the center and therefore over how succession politics will go. So there is a debate within the Chinese leadership about this issue. Perhaps Charlene could elaborate on it as well, as to whether it suits China to continue with the present circumstance, negotiating but not reaching conclusion, or to go forward to get these other benefits which Charlene outlined.

Mr. BEREUTER. Thank you very much. The gentlelady from Kansas, Mrs. Meyers.

Mrs. MEYERS. Thank you, Mr. Chairman. Madam Ambassador and Mr. Secretary, I am very glad to have you both here and thank you for your testimony. On a scale of 1 to 10, what do you think are the chances of China abiding by this agreement?

Ms. BARSHEFSKY. I think the chances are actually very good. I say that because if we look at other agreements, for example, our market access MOU, China has not abided by all of the obligations, but they have abided by many and in some cases have actually accelerated market access in areas under the agreement. Or if not accelerated, made the terms even more favorable than what had been previously negotiated. But I don't think that we can assume China will comply, any more than we can assume many countries around the world will comply. We have to try and do our best to assure compliance by a combination of technical assistance, putting our own people on the ground in terms of market access, and then using our trade laws if we need to again.

Mrs. MEYERS. I don't mean to get into some kind of a speculative area here, but is there any kind of a trigger in the agreement as to what we will do if we do get evidence that they are breaking the agreement? Or do we just go back to the drawing board and threaten them again and go on from there?

Ms. BARSHEFSKY. We have in the agreement a very elaborate verification and consultation package. There are a variety of data that China needs to provide to the United States on a quarterly basis. Establishments raided, what was the intellectual property type, for example, software, CD, LD and so on, what was confiscated, was it destroyed, was the equipment destroyed, if so, how much, did the case go to court, was there a criminal referral, so on and so forth. These data are supplied to us quarterly. That dovetails with a system in the first year of quarterly consultations. So first off, if we see any diminution in China's resolve to enforce intellectual property rights, we will have consultations under the consultation mechanism, try and see what the problem is and try and get the problem fixed rapidly. But let me be clear. We have not foregone any of our trade laws in this process. And if we need to, we will obviously use them again. I would like to think a little more positively about this, and with the combination of the verification and consultation process and the other elements of the agreement, I would like to believe that we and China together can get there with respect to the eradication of piracy.

Mrs. MEYERS. One final question, Mr. Chairman. The pirate companies that were involved, do we know—were these just entre-

preneurs or was there some connection with local government, the military, with government in some way?

Ms. BARSHEFSKY. It is a combination. We believe that some factories have Chinese Army participation. Some factories have municipality participation at a governmental level. Some factories are entrepreneurs, perhaps even Taiwanese or Hong Kong entrepreneurs or Taiwanese or Hong Kong investment. It is a combination of factors. One of the reasons market access is so important for U.S. companies is that it allows U.S. companies to form legitimate partnerships, either with former pirates or with new management entirely, to clean up the factories.

Mrs. MEYERS. Thank you, Mr. Chairman.

Mr. BEREUTER. Thank you, Mrs. Meyers.

The gentleman from Kansas, Mr. Brownback.

Mr. BROWNBAC. Two Kansans in a row here.

A couple of questions following up. How many officers have the Chinese committed to enforcement of this privacy agreement, force structure?

Ms. BARSHEFSKY. I don't have a number for you. We have an enforcement structure that combines the current enforcement that authorizes in each of the relevant ministries, which is a significant number—I could probably get the number for you, but I don't know it offhand—coupled with the police in each locality, the procuratorates, the prosecutors offices in the localities, coupled with special task forces formed on an IPR-type basis, a copyright task force in a locality or a software task force.

Mr. BROWNBAC. I understand they are committing their whole structure to task forces but did they give you—we will have at least 1,000 officers that we will be dedicating full-time to enforcing this?

Ms. BARSHEFSKY. The answer is, I don't know.

In my discussions with them a number didn't come up, but to be honest, it may have come up in prior discussions.

Let me find out and get that to you.

[The information appears in the appendix.]

Mr. BROWNBAC. All right, because it is a big country with a lot of people and these are things that could move pretty easily from point to point. What do you think it will do to the trade imbalance between the United States and China. This is one of the highest imbalances we have around the world, with China, this agreement.

Ms. BARSHEFSKY. I can't give you a figure on that. We believe, the industries believe that exports from the United States will increase. They believe that their competitive posture in third country markets will improve as pirated goods from China no longer enter those third country markets. But whether we could calculate with any precision what it would do to the imbalance in the trade markets, I doubt.

Mr. BROWNBAC. Nobody has done any projections.

How do you intend to get at that trade imbalance looking forward? Has China joined the WTO; because this has grown over the last 10 years, our imbalance with China.

Ms. BARSHEFSKY. Certainly, from the point of view of USTR, a key element has to be market access. If China has market access in the United States, our trade policy needs to be based on expecting reciprocal access in the Chinese market.

If they can sell their electronics here, we should be able to sell electronics and other products in China. We have a relatively open market for Chinese goods. We need to see the development in China of that kind of receptivity to American goods.

WTO accession alone would do that unless we are certain that accession is on a commercially acceptable basis, that is on a basis that in fact provides up front for agreed market access commitments. We need to be sure that we get that before the United States commits to have China in the WTO.

Mr. BROWNBAC. Do you see those negotiations occurring and concluding over the next 2 years?

Ms. BARSHEFSKY. I can certainly see the negotiations occurring depending on the Chinese's desire to resume negotiations or not, and I don't think that decision has been made yet at the leadership level. But in terms of when they will conclude, I think it is hard to tell.

Again, it depends on the political will of China and the desire to undertake the level of commitment we would expect to see with respect to market access and other basic GATT WTO obligations.

Mr. BROWNBAC. Thank you.

Mr. BEREUTER. The gentleman from American Samoa, Mr. Faleomavaega.

Mr. FALEOMAVAEGA. Thank you, Mr. Chairman.

Ambassador, I don't know if you might have the figures, but I am curious if you could submit it for the record—I would be curious to know what the dollar value of the worldwide scale in terms of the countries that violate intellectual property that belongs to our country and our companies, and I am also curious to find out what percentage of that involves China. In fact, I would like to know what are the total dollar value of the losses incurred by U.S. companies on intellectual property violations with China that we have had on that basis.

[The information appears in the appendix.]

Mr. FALEOMAVAEGA. I join the gentleman from Wisconsin's concern about enforcement. When the PRC was founded in 1949, we had to deal with 400 million people. Now we are dealing with 1.2 billion citizens of that great country. I understand that they have 3,000 parliamentarians.

I can't imagine how an election takes place if they don't have the technology to do any vote counting, for example. So I am curious, because my understanding also is that the central government is having a very difficult time reining in some of these provinces and doing some of the economic trades on their own.

In fact, there are a couple of provinces that have invited I think several members to visit their offerings and what they can do. My understanding is that it is almost like a confederation at this time, more so than a centrally controlled government. Can you comment on that?

Ms. BARSHEFSKY. I can tell you that we would be concerned about relying solely on Beijing with respect to IPR enforcement, but the agreement makes very clear that provincial, sub-central and local government involvement is also necessary, and the agreement provides at every stage for the involvement, not only of Beijing and the ministries there, but also all of the sub-central gov-

ernments that flow down from Beijing with respect to IPR enforcement, and it is for the concern you indicate, which is to expect Beijing alone to undertake this task would neither be realistic nor effective.

Mr. FALEOMAVAEGA. Now that we have lowered the boom on China concerning intellectual property rights, to what extent are we applying the same pressures on other countries like France, Taiwan about the violations of the same thing that we are talking about? Are we applying equal pressure or are we going by numbers or what formula is the administration applying—my concern is that China is going to say one day, hey, listen; we are going to comply only to the extent that other countries are going to comply with the same thing that you are asking us to do. Do you understand my concern?

Ms. BARSHEFSKY. Yes. With respect to Asia, China is not alone in threatened sanctions. Korea is a case in point, Thailand is a case in point, Indonesia is a case in point. There are a number of other countries in Asia where we have had to threaten sanctions in order to see movement.

Mr. FALEOMAVAEGA. What about Europe?

Ms. BARSHEFSKY. In Europe, Italy. We have continuing problems with Hungary, with Turkey, with Poland and elsewhere. We are in a process now of embarking on our special 301 review, a review that is completed by April 30, where we review the intellectual property rights regimes—

Mr. FALEOMAVAEGA. So the bottom line is you are applying equal—we are not just picking on China?

Ms. BARSHEFSKY. We are attempting to keep the pressure up worldwide.

Mr. FALEOMAVAEGA. To Secretary Tomsen, you know, it is really interesting that Taiwan and the PRC is having their social problems, but I understand they continue to have a \$11 billion trade relationship informally, and that citizens of Taiwan freely visit PRC. I am a cosponsor of a resolution introduced by the gentleman from New York to admit Taiwan to the U.N. What is the administration's position to that?

Mr. TOMSEN. Our position is that would be inconsistent with our unofficial relationship with Taiwan, which not only this administration but previous administrations have adhered to. The U.N. only accepts countries under Article 4 of the U.N. Charter. So in consonance with our policy of unofficial relations with Taiwan, we moved our embassy and our diplomatic relations to PRC in 1979. We could not support Taiwan's entry into the U.N.

But I want to quickly add that in last fall's Taiwan policy review which we have discussed, it does call for the administration, for us to attempt to assist Taiwan's entry into organizations, international organizations where statehood is not a requirement, but to assist Taiwan in participating in organizations where statehood is required.

Mr. FALEOMAVAEGA. Thank you, Mr. Chairman.

Mr. BEREUTER. I can exercise the prerogative of the Chair. And, therefore, it would be possible for the United States to support Taiwan for membership in the WTO; is that correct?

Mr. TOMSEN. Yes.

Mr. BEREUTER. The gentleman from Ohio, Mr. Chabot.

Mr. CHABOT. Thank you. I will be brief.

Approximately 10 years ago, it is my understanding that the U.S. exports to China were in the area of about \$3 billion, and exports from China to the United States were about \$3 billion. Since that time, in the last 10 years, our exports have gone from \$3 up to \$8 billion, but their exports to us have gone up to \$38 billion, which is a huge disparity in which way we have been heading.

My question is—and one other thing I would like to mention—I had an opportunity to meet with some manufacturers from my State, Ohio, yesterday, and they were talking about their involvement with China and Chinese trade and the government over there makes it very difficult, and they are talking about markets which really aren't open or aren't as open as they should be.

I am just wondering, what is the administration doing to position themselves to be tougher on really enforcing this agreement and any future agreements with the Chinese?

Ms. BARSHEFSKY. If I may, let me comment on the trade figures. There is no question that the trade imbalance is large, it is growing rapidly, and is and should be of serious concern.

Let me note two things about it, though. First, we used to have an even greater trade imbalance or a very great trade imbalance with both Hong Kong and Taiwan.

As Hong Kong and Taiwan capital moved to the Mainland and production facilities followed, you saw a reduction in our trade imbalance with Hong Kong and Taiwan and a corresponding increase in our trade imbalance with the PRC. So part of what you are seeing in the numbers has to do with a shifting of trade imbalance from Hong Kong and Taiwan to the Mainland as against the United States.

The second point has to do with the composition of trade. China's chief exports to the United States are textiles, toys and some electronics. Our chief exports to China are aircraft, computers and electronics. So with respect to the composition of trade, the United States is well positioned, although, obviously, there is a significant market access issue there.

In terms of what the administration is doing with respect to enforcement, I think it really is a question of indicating what I have just said. We have been very aggressive on enforcing the market access MOU.

We will be very aggressive in ensuring enforcement of this intellectual property rights agreement. We have to continue market access negotiations, and we have done so. We have very active negotiations in services as well as on other goods sectors and on agriculture.

Those are continuing on a bilateral basis independent of the GATT talks. And then, of course, we also have market access discussions and rules changes in the contexts of the GATT talks. We need to bring all of these elements to bear if we are to have any significant impact on the trade imbalance.

Mr. CHABOT. Thank you very much.

Mr. BEREUTER. Thank you Ambassador and Secretary Tomsen. In your presentations here and your responses to our questions, you have been helpful, not only to the committee but to the Amer-

ican public and other interested parties as well. Thank you very much.

I would recognize that the gentleman from North Carolina, Mr. Ballenger, has been here but had a conflict and had to leave.

I would like to call now the second panel.

For the record, although I previously introduced them, the second panel consists of the Honorable Beau Boulter, former Congressman from Texas and author of the article "President Clinton's China Policy: Human Rights the Bottom Line."

Congressman Boulter is very active in export and trade issues generally.

The second witness, Dr. Robert Kapp, is president of the U.S.-China Business Council which represents 280 American business corporations with substantial trade and investment interest in China.

Gentlemen, thank you for taking time to participate in our hearing today and to give us your point of view. We had many people who volunteered for this opportunity. We thought that you had things to say that were important to the committee, so we welcome your testimony.

Congressman Boulter, would you like to proceed?

The buzzer is ringing, and you remember how that goes, but I think that you can start.

**STATEMENT OF HON. BEAU BOULTER, INTERNATIONAL
TRADE CONSULTANT AND FORMER U.S. REPRESENTATIVE
FROM THE STATE OF TEXAS**

Mr. BOULTER. Thank you very much, Mr. Chairman.

It is a privilege for me to be here following these two witnesses, one of whom certainly concluded a very, very important trade agreement with China. I want to say at the outset, that I personally believe China is going to make a very good-faith effort to live up to this agreement.

I think that if they did not have that intention, they would not have made the agreement. I think it would be too risky for them. By the same token, I don't think we should sit back and not watch them. We do have to watch them carefully and assist them and help them enforce this agreement.

I think following the agreement, Mr. Chairman, that now is the perfect time, and I am summarizing my testimony—

Mr. BEREUTER. Your statements will be made part of the record in there entirety.

Mr. BOULTER. Now is not only the time for China to continue to open its markets and liberalize its trade regime, but I think also that 1995 is the year that the United States should do two things with respect to China. One is to remove the conditionality of Jackson-Vanik toward China. Second is to do everything to work with China and honor the commitment that we made in the October 1992 settlement of the market access case to really support China's entry into the WTO.

I say these things for two reasons. First of all, I think that China has made a lot of progress in its trade regime in reforming its trade laws and I detail that in the written testimony.

Secondly, I think that the philosophy of GATT, of the GATT from 1947 until now, is still a good philosophy and that therefore China should, I think, assuming they live up to this agreement in a fairly good fashion—I don't think we have to require them to do it perfectly—nobody does things this complicated perfectly—but assuming good faith with the IPR enforcement, I think that by the end of the year, China should be admitted retroactively into the WTO.

I noted that the Deputy Trade Representative talked about that, about the progress that China had made in the 301 market access case, especially in the area of transparency, but also in reducing some of the tariff and nontariff barriers, import licenses and things like that. I think while they have a long way to go, still, China has made good progress.

Even on the issue of convertibility, which is a very complicated issue, they are working on that. On the issue of stabilization, at least they have imposed very narrow margins in which their currency can fluctuate, so they are trying to address this devaluation of their currency, a problem which impedes our ability to export into their country. So we do want more progress from them, but I think they have been coming along.

The principal dispute, I believe, between China and the United States, in terms of WTO membership, has certainly been over the status that China should have coming into the organization, whether it might come in as a highly industrialized nation or as a lesser developed nation.

As you know, that question was talked about at length at the APEC forum in Indonesia late last year and was not resolved. It was glossed over there. It can't be glossed over as we talk about admission into the WTO. It has got to be settled.

I think that in the end that it will be in our interest to recognize that we are going to have to let China into WTO and give them some flexibility in phasing out their tariffs and nontariff barriers.

China's leaders know that continued trade liberalization is in their interest. I think they will work very hard to do this. I think under the Deng reforms that a lot of progress has been made.

On MFN, since China was granted MFN originally in 1979, the immigration criteria of Jackson-Vanik has never been used against China. It has never been a serious issue. When President Clinton reversed his policy by extending MFN to China in 1994 to delink human rights from the trade issue, he was recognizing that trade sanctions do not really promote human rights in China.

When I was in Congress, I served on the Executive Committee of the Human Rights Caucus. Believe me, I am extremely interested in this issue, but I think that we have to keep the trade issue separate from the human rights issue. It is for the sake of human rights, largely, that I think President Clinton was correct in reversing his policy last year.

I would hate to see Congress reestablish any linkage. It was a bad idea to begin with, and I think particularly during the succession period, when there may be some political instability, that it would be particularly bad to relink those two issues.

All of America's goals will be better advanced if MFN is not only kept separate from human rights considerations, but if MFN is granted to China without Jackson-Vanik conditionality. Our goals

in this region include, not necessarily in this order, human rights, democracy in China, a viable trade relationship, security arrangements in the region and nonproliferation of weapons of mass destruction.

I think it is possible that trade, freer trade will foster entrepreneurs and intellectuals in China much like it has in South Korea, Thailand and Taiwan, and eventually it is possible that we could see elections there nationwide, not just in the rural villages, where they are beginning to occur.

Having put economics and security arrangements, rather than human rights, at the center of our foreign policy toward China, the United States must continue to recognize its challenge to invigorate the spirit of private enterprise there and keep working on that. China's rise is going to be tumultuous at times, but it will be in our interest to play the role of a partner with China, as it definitely is on the way up.

Normal trading status, including unconditional MFN, including membership in WTO, are important, not only for China, but also for the people. I am not talking about the Government of China.

I am talking about the people of China, many of whom I have gotten to know, in the ministries, and also students, and dissidents in the prodemocracy movement. It is rare for me to see people in China who are opposed to normal trade relations. They don't want the sanctions, they want normal trade relations.

But I also think it is in our interest, because our interest is inextricably linked to furtherance of China's reforms. So I think this was a good agreement on February 26, but we must continue to bring China into the international community to promote world peace and economic progress worldwide. It is in America's interest to do so.

[The prepared statement of Mr. Boulter appears in the appendix.]

Mr. BEREUTER. Thank you very much.

I am going to declare a 5 to 8 minute recess. Chairman Roth will resume, and I will return as quickly as possible.

So we will be in recess for 5 to 8 minutes.

[Recess.]

Mr. ROTH. I think we will continue with our hearing, and Mr. Boulter has completed his testimony.

Dr. Kapp.

STATEMENT OF ROBERT KAPP, Ph.D., PRESIDENT, U.S.-CHINA BUSINESS COUNCIL

Mr. KAPP. Thank you, Chairman Roth. First, let me say that when I drafted this testimony at home yesterday morning, I had in front of me an invitation from Chairman Bereuter, and as a result, the first line of my remarks is addressed to him.

Please excuse me; I do understand it is a hearing of two subcommittees. I trust my full remarks will be put into the record.

Mr. ROTH. Without objection.

Mr. KAPP. In their absence, let me take a moment to congratulate Ambassador Barshefsky and her two deputies for their achievements. I was in Beijing last week on Council business, and I watched in the lobby of our Representatives' hotel as they stepped

out of the elevators; dozens of reporters had microphones under their noses and accompanied them to their cars. It was a period of great tension, and they conducted themselves with tremendous firmness and skill. The result is a happy one.

On the subject of software, as I completed this testimony yesterday morning at home, I pushed Spell Check to make sure there weren't any typos, and the entire screen went blank. The message was, "System has gone down," and it was only thanks to the skill of a very valued computer technician, whom I got on the telephone, that I was able to bring this to you today. So even the best computer efforts can sometimes go awry.

Mr. ROTH. We appreciate the extra effort you made to be here.

Mr. KAPP. Mr. Chairman, I have made three or four points in the written record, and they speak pretty much for themselves. I will review them with quickness and add a couple of comments.

After the preliminaries and the introduction of my Council, I have tried to make a few reflective points at the moment when this period of tension over intellectual property has been concluded. The points are these.

The first is that trade disputes are inevitable among major trading partners. They are not terribly pleasant, but they are a normal phenomenon and they are best handled, as this one was, when managed within the established structures of trade dispute resolution and when they are not casually or intentionally intermingled with nontrade issues.

I elaborate on the point in the testimony, but I think this is one of the lessons of the successful conclusion of these negotiations. Though it was hot and heavy from time to time, and the media coverage was very intense, the negotiators on both sides struck very close to the issues, the trade conduct issues, the dollar values at stake, the trade-related measures that were threatened against one another, and in the end, the trade negotiators were able to cut a very impressive deal.

I think the lesson is important as we look at the range of issues and problems that the United States and China face. There is value in dealing with trade issues within their own framework and not allowing them to be overwhelmed by issues from other sectors of the spectrum.

The second point that I have tried to make is that on the question of the "rule of law" which we have been reading about at great length in the mass media in the last month, and which has been on many people's minds for years and one could even say centuries, with regard to China, I think the lesson of this agreement is that international trade activity, the international business activity of the United States in particular, leading as it does to the enhancement of formal commitments by the Chinese Government to operate with impartial and established legal institutions governing the conduct of their own citizens in the realms of economic behavior, supports the extension of that rule of law to which Americans pay such important attention.

It is sometimes argued that American business, dealing with China, is unconcerned with or irrelevant to the rule of law, or at the very least, that it simply suffers from its absence. I would argue on the basis of the concluding experience of the past week,

that indeed—as some have argued in the MFN debate earlier—American business operating in China plays a constructive role in assisting in the development and furtherance of the rule of law as we like to think of it in the People's Republic.

Third, we have to recognize that the way in which United States-Chinese disputes are handled in the media—and we all recognize the enormous value of the media in informing public opinion and, thus, in informing political decisionmaking—can be instructively viewed in this case. I cite the example of my own experience.

From the day that Ambassador Kantor on February 4 announced the likelihood of specific sanctions and set a deadline of February 26 for the conclusion of the final negotiations, until that concluding day, I must have done personally 30 to 40 TV, radio and print media interviews, some of them very long and some on the order of 20 seconds. I was amused to note that from February 26 until now, I have had but one call—from Radio Australia—and nothing else with regard to media interest in this issue.

It tells a little bit about the way in which conflict sells, and about the way in which unresolved conflicts seem to make for more intensive media attention than resolution. I think we need to bear that in mind as we watch the volatile course of relationships between ourselves and the People's Republic of China.

The last point is one which Congressman Boulter and Deputy USTR Barshefsky and Assistant Secretary Tomsen made: as with all agreements with China and other countries, this one will require vigilance. I am particularly concerned because I think, having worked in the China field for a long time, that there are always ambiguities of translation.

It is OK in these comments to translate “fan belt” or “sodium hydroxide” in a particular way. Those kinds of terms are easy to translate. But when it gets to verbs, such as “will implement,” there are lots of ways to translate into Chinese.

The ambiguities built into the language will make it very interesting to see the Chinese version of the text, which will be effective and will be the one by which the Chinese sail. We will want to make sure in the future that the opportunities to claim misunderstanding in retrospect are kept to a minimum. Some of that, I think, is unavoidable, and we shouldn't be surprised if a year or two down the line that we discover that we didn't quite agree on what we thought we agreed to at the moment of signing.

A couple of additional points. The first relates to the claim, which no one has adduced today but which has been adduced widely in the last week or so, that the IPR successful settlement proves that if the United States only stands firm enough and tough enough similar results can occur; that is, the United States can prevail as fully in other issues. I think we have to be very careful with this logic and, in fact, I don't think it is correct.

Over the last month, there has been a very, very extensive series of articles in some of the major national newspapers, mainly op-ed pieces and the like, making this argument. But I think it is important to understand, as I went to my first point, that the IPR case is a trade case. It was handled under U.S. trade law. It entailed specific trade-influencing or trade-affecting behavior as provided for in U.S. law. The elements of this case are the standard subject

matter of international trade discussions. That is why when we did stand firm, the business community and the government, I think it really helped the United States to gain a successful outcome.

But I believe that one has to understand that some issues are trade issues and some aren't, and that before we assume that this is a kind of a generic example of America "standing tall" and prevailing by sheer force of will, regardless of what the subject matter might be, there are real and important analytical distinctions that make it not necessarily true that we would similarly prevail in other less trade-specific cases.

My final point, Mr. Chairman, is just that I am fascinated by the sudden disappearance of a theory that was rampant no more than 2 weeks ago, i.e., that the failure of the PRC to settle this case was proof that the leadership was in disarray and unable to make decisions in China. I have no particular interpretation of the current status of China's leadership politics as a result of this agreement, but it struck me and others that whereas 2 weeks ago many of us were reading daily that the Chinese were simply unable to get their act together and make decisions and come to the table with a meaningful offer in the case of the intellectual property negotiations, this analysis seems to have evaporated since, in fact, they did come to the table.

So we will have to see whether this interpretation of leadership paralysis in a period of succession raises its head again on other issues such as the GATT and WTO, and whether it proves more accurate in those cases than it has in the case of the IPR.

Thank you.

[The prepared statement of Dr. Kapp appears in the appendix.]
Mr. ROTH. We had interesting testimony this afternoon.

Mr. Boulter, I had to run over and vote, but I had a chance to review your testimony. Knowing you from being a colleague of ours in the Congress, I know how dedicated and thorough you are. The question I had for you is, the Japanese and the Europeans, the Canadians, they all grant MFN to China, don't they?

Mr. BOULTER. Yes.

Mr. ROTH. Does any other country deny them MFN rights, link it to human rights as we do?

Mr. BOULTER. No. Not that I am aware of.

Mr. ROTH. We have a company in my hometown of Appleton, Wisconsin, that does a good deal of trading with China and has talked to me about this and are rather sensitive to the issue. What has been the reaction when you have worked with the Chinese?

Mr. BOULTER. I really appreciate that question, because I think it goes to the heart of the way I feel about it. I want to stress that the Chinese people I have worked with, by and large, fall into two categories of people: One is the category of the dissident or the student or the academic, or the prodemocracy person. That is one camp of person I have worked with.

The other is the Chinese person that I have worked with is the person in the government, typically a member of the Communist Party, typically a director or assistant director of a department or ministry, but nevertheless, typically reform-minded.

What impresses me is that most of the dissidents and the students and the scholars want MFN to be permanently delinked from human rights, the very people that are fighting for human rights.

It has been interesting to me that here in Washington, D.C. the human rights organizations feel differently about it, but on the ground, it has been my experience that most of the people on the frontline want to see trade delinked from human rights.

Mr. Chairman, I not only think that we should remove MFN from human rights considerations, but also from the Jackson-Vanik immigration condition as well.

Mr. ROTH. We have about \$25 billion trade deficit with China now?

Mr. BOULTER. Probably. I think it is approximately \$29 billion.

Mr. ROTH. What are we going to do about that?

Mr. BOULTER. I think that this agreement that was concluded on February 26 helps address that problem. But first of all, I am pretty much of a free trader. I don't know if you remember that about me or not. But I don't think that it is necessarily horrible that we have a trade deficit.

Secondly, I think that China is opening up its markets and that this agreement goes a long way toward doing that.

Thirdly, I think it is real fundamental to your question that China be a full participating member in the global trading community, which means membership in the World Trade Organization. That will provide a better forum for negotiating access to their markets than a whole series of contentious bilateral trade agreements which get hung up on all sorts of nontrade issues, in my view.

Mr. ROTH. Dr. Kapp, can China really police this agreement, and are they going to have the will to police it?

Mr. KAPP. It will be a struggle, Congressman. Ambassador Barshefsky is right in saying that document they have signed calls for the establishment of a whole range of central, subcentral and local enforcement bodies. If you will pardon my saying so, it resembles a nightmarish version of what, in our country, Congress is now attempting to reverse: suddenly overnight, if I understand the document correctly, it calls for the creation of a vast range of inspectors and reporters. It will be a challenge just to get that administrative system up and running.

Mr. ROTH. They will probably have a contract in reverse.

Mr. KAPP. I was thinking this morning if I could count the number of Chinese citizens who could tell me what the Contract With America and the New Covenant mean, and I concluded it was probably about 30. These are matters which have not penetrated into the public dialog over there.

But seriously, the creation of a system like that is administratively very demanding. Ambassador Barshefsky's point is that, after all, it is their government. What we can do from the outside and what had we have done is negotiate the creation of those instruments by which the Chinese Government, sometimes with American help, can go about policing and discovering and enforcing.

It is not going to be perfect. Many of the problems we have as a government with China now in the economic sector, and certainly

that businesses have, stem from the increasingly ambiguous relationship between central government and provincial and local governments, on the one hand, and also between government itself and so-called private or nongovernment entities, on the other.

The clarity of lines that used to characterize the socialist system in China has evaporated and we find ourselves stumbling through these mine fields of ill-defined roles now. That will be an issue with regard to this agreement, but I think the agreement couldn't go much further in prescribing ways for these abuses to be brought under control, and I think the American negotiators have done very well.

Mr. ROTH. With this trade deficit that we have with China, how can we get more balance to it? We have a huge trade deficit, and as long as our economy remains strong, I think it is workable. But if we have any kind of an economic downturn, these fellows over here, these men and women on the floor of Congress will start feeling the heat back home. How are we going to get that back into more equilibrium?

Mr. KAPP. With regard to its political significance in relation to the Congress, the trade deficit, which takes the immediately recognizable form of lines on a graph, is a very accessible issue and a handle on which to engage in a discussion of our problems with China. I do worry about that politically, because it is important that we not fall back into lumping into one large mass, all the different kinds of things that we might find objectionable or that we might take issue with in relation to China lest we poison the entire well instead of removing the difficult elements one by one.

How one eliminates a large trade deficit, we don't have an answer in full. We need to export more. That means open markets. Does it mean absolute trade balance? It may not.

The Chinese know that they cannot afford to buy modernity and therefore they emphasize bringing in American investment in which they emphasize exporting to the world. It is important to understand, in discussing the U.S.-China trade imbalance, in addition to the points that Ambassador Barshefsky made about the Taiwan and Hong Kong surplus dropping as the Mainland surplus rose, that a chunk of China's exports to the United States now consists of products from plants in which American companies have very profitably invested. Those components may come back for inclusion in finished products made in the United States.

There are many things that go into the making of this PRC trade surplus. A perfect answer doesn't exist and I think most economists would argue that perfect balance is not necessary on a country-by-country basis. But you are right; politically, it is potentially volatile and we are concerned about it.

Mr. ROTH. Chairman Bereuter.

Mr. BEREUTER [presiding]. Thank you very much, Chairman Roth.

Building on the last question, I would like to ask both of you, how do you recommend the United States try to address the remaining trade barriers that seem to exist, not tariff barriers primarily; how do we make some progress by reducing barriers?

Mr. BOULTER. On the nontariff barriers?

Mr. BEREUTER. Yes.

Mr. BOULTER. That is just a long-haul project by and large. I am personally encouraged in the area of import licenses, import controls, import substitution lists and some of those things that we have made progress with them. I don't think there is any quick and short answer, except to keep tough on the issues. I think that if we can keep human rights out of those discussions, that will help make progress on that.

One of the main problems we have right now in China that makes these nontrade barriers so significant is that China itself is sort of decentralizing their government, and there is less transparency at the provincial and municipal level than there is at the center. I don't know that there is a whole lot we can do to get a handle on that part of the problem. But certainly, the market access issues that are addressed in this agreement and in the October 1992, 301 agreement, are just something we have to keep watching.

Mr. BEREUTER. Dr. Kapp, do you have any thoughts about how we go about reducing further, more rapidly, the nontariff barriers that exist?

Mr. KAPP. It is instructive to look at the documents that came out of Geneva at the end of the year after the GATT accession talks broke off without result, the report of the working party and the draft protocol of accession which were created by the chairman of this multination GATT accession party. For all their incompleteness and the areas of so-called bracketed text, where agreement was not reached, they laid out an amazing range of changes in the way the Chinese economy would function including, importantly, a series of required eliminations and reductions of so-called nontariff measures that are very characteristic of Chinese international economic behavior today.

Now, the Chinese didn't agree to it and the talks broke off with considerable ill-humor. My impression from recent meetings in China is that domestic pressures on the part of the Chinese negotiators not to give further ground were lethally strong. Nevertheless, one can hope, and I expressed that hope to the Chinese colleagues that I met with in China, that the Chinese would be able to reach a domestic resolution quickly enough to return promptly to the GATT negotiating table. That is, I think, the most promising avenue for encouragement of reduction of NTM's, some over time; those are the things you negotiate in a GATT accession. It is a very impressive list which would bring about fascinating and large changes in Chinese economic behavior.

Mr. BEREUTER. It is an impressive list.

Congressman Boulter, one of the points of distinction that I think you made related to the status that the PRC would have when it comes into the WTO. You suggest, as I recall, that the United States' demand that China enter the World Trade Organization as a developed country is unreasonable; and given the relative poverty, it should come in, in other words, as a developing country if we do that. That stands in contrast to support the United States seems to have from other industrialized countries.

Won't the United States lose substantial leverage in getting its most beneficial trade terms, and isn't it in China's interest to liberalize as quickly as possible?

Mr. BOULTER. Yes, it is. It is in their interest to do it as quickly as possible. I think that is the key phrase.

The terms of WTO membership are not really written in stone. They are ambivalent, subject to interpretation, they are vague. I don't think you can say, on the one hand, country x is a highly industrialized nation necessarily, and on other hand, it is a lesser-developed country necessarily.

With some countries you can do that; with some countries it is hard to do that. China, for example, huge economy, number three in the world, maybe the 10th biggest exporting nation in the world; it is a big player on the world scene. So from that standpoint one might argue that they are more like us. On the other hand, it is a hugely complicated country that has been run by a Communist system, and while it is in their interest to do this as quickly as possible, as you say, I think it is going to take time.

All I am suggesting is that I think we can take too hard of a line on the terms under which they come in and I think that some flexibility, especially on these nontariff barriers, is going to have to be given. Otherwise, I think that the trend will be to isolate them from the world trading community, which I think will be bad for everybody concerned.

Mr. BEREUTER. Your primary reason for viewing them as properly categorized as a developing country is the state of their development, the poverty, et cetera?

Mr. BOULTER. Yes, sir; the state of their poverty, the state of their lack of cohesiveness in many ways, the complexity of the situation, the hugeness of their country. But mostly, yes, the state of their poverty, the state of their still somewhat deficient legal infrastructure, and things like that, yes.

Mr. BEREUTER. One final question for Dr. Kapp. If the United States and the European Union countries agree that the PRC has made significant progress and that access to their markets is increasingly being offered now to foreign products, and if further commitments are made by them as part of their accession to the WTO, what effect do the remaining Jackson-Vanik provisions have on the PRC's membership with regard to the United States?

Mr. KAPP. As I understand, the effect of Jackson-Vanik is that even if through bilateral negotiations with us as the largest and most important party concerned with China's accession the Chinese were to do everything that we demanded of them, and even if on that basis they acceded to the GATT and became a GATT member, we could not as a nation treat them as a GATT member because the Jackson-Vanik requires the annual review and certification by the President, subject to the possibility of reversal by the Congress, of the status, which is absolutely fundamental to the GATT, namely, Most-Favored-Nation.

Mr. BEREUTER. Do we have that situation with any other countries?

Mr. KAPP. We have some other countries to whom we don't grant MFN. I presume some of them must be GATT members. There are five or six.

Albania—there are five or six. There is nothing remotely like this, no significant trade partner, and certainly none of the larger economies, with whom we don't have MFN relations.

Mr. BEREUTER. What specifically would be your recommendation to us in terms of Jackson-Vanik with respect to the Peoples Republic of China?

Mr. KAPP. This is a personal view. This is not the voted view of the board of directors or the membership of the U.S.-China Business Council, but it seems to me, as to Congressman Boulter, that since the immigration issues which define Jackson-Vanik really are not on the table in relation to our treatment of the PRC, we and the Chinese alike—and world trade and world economic relations alike—would be better off if we were freed from the straitjacket of annual MFN review under Jackson-Vanik, and if it were possible to simply accord MFN and do so in the context of a world agreement in which it was automatic and perpetual.

The Chinese, I must say, can be forgiven if they ask themselves whether all this labor and arm wrestling with us over specific terms of accession—three bank branches in four cities, or four bank branches in three cities, et cetera—is really worth the effort, when at the end of the day, we are not going to treat them like a GATT member anyway. That anomaly is something that strikes many of us very strongly.

The issue is a political one, however. I can say that there are many who believe that a full frontal assault on Jackson-Vanik for a variety of reasons in the American political and congressional environment would probably not succeed and would be politically very risky. Some of those issues don't relate to China at all, but relate to the situation in other parts of the former Soviet Union around which the original Jackson-Vanik amendment was crafted 20 years ago.

Mr. BEREUTER. Gentlemen, I very much appreciate your contribution here today and look forward to going over your testimony again, as I didn't get to hear your formal comments, Dr. Kapp. I apologize for that.

I will say to my colleague, I appreciate the opportunity to hold a joint hearing with you, and I yield back.

Mr. ROTH. Thank you very much.

The hearing is adjourned.

[Whereupon, at 3:55 p.m., the subcommittees were adjourned.]

APPENDIX

OPENING STATEMENT

THE HONORABLE DOUG BEREUTER CHAIRMAN, SUBCOMMITTEE ON ASIA AND THE PACIFIC

March 2, 1995

Today's hearing is the third joint hearing of the Asia and the Pacific and the International Economic Policy and Trade Subcommittees of the 104th Congress.

On February 9, 1995, as Chairman of the Asia and the Pacific Subcommittee, I stated three fundamental principals or goals which I felt should be the basis for the subcommittee's agenda. One of those was that the United States must better focus and augment its resources to defend our economic interests, to expand our commercial opportunities, and to ensure American competitiveness in the region.

Last Sunday, Ambassador Mickey Kantor announced that the United States had successfully completed a comprehensive agreement with China on that country's commitment to enforce its intellectual property laws. It has been estimated that China's failure to protect U.S. intellectual property rights has cost U.S. companies over \$1 billion annually.

Just two days before Ambassador Kantor's announcement that the Special 301 trade sanctions would be suspended, Secretary of Energy, Hazel O'leary, announced that U.S. and China commercial interests had signed contracts totaling \$4.6 billion on energy development in that country.

Although conflicting messages from the Administration have previously caused China to firmly rebuke our demands, these two developments have conversely underscored the value of firmness in the promotion of U.S. trade interests. The likelihood of sanctions did not cause Beijing to retaliate against U.S. interests. Instead, it forced them to make a strategic choice in the direction of maintaining a valued economic relationship with the United States.

Whether this outcome validates the Administration's "Comprehensive Engagement" strategy towards China remains arguable because the U.S. government has not exercised similar degrees of firmness in all situations and because the United

States does not always enjoy the same degree of leverage. Nevertheless, this positive outcome provides -- on the one hand -- a very detailed and measurable agreement on intellectual property rights -- and on the other hand -- important agreements for U.S. investors in the region.

These simultaneous actions represent a constant dilemma for U.S. foreign commercial policy with China: When is it appropriate to persuade China with sanctions and when is it appropriate to persuade China with rewards? And, Can economic leverage serve political objectives?

Although the IPR agreement represents a substantial improvement in U.S.-China commercial relations, several commercial and foreign policy issues remain to be addressed, and there can be no doubt that there will be disagreement on which method to employ.

For example, the IPR agreement could be seen as a positive indicator in the now stagnant negotiations over China's accession to the World Trade Organization, since the terms of that accession will largely be determined by the United States and her allies.

Similarly, human rights advocates have already alluded to the IPR agreement as an example of what the United States can accomplish with a unified and coherent policy. This argument is likely to be a part of the annual Most-Favored Nation or non-discriminatory trade status debate.

Meanwhile, U.S. business interests have indicated that the United States should re-examine U.S. commercial sanctions, such as the prohibition on U.S. export promotion agencies from operating in China, and remaining Jackson-Vanik provisions which would prohibit the United States from fully recognizing China's accession to the World Trade Organization, when that occurs.

Obviously, policymakers may disagree over which method to apply in each of these important foreign policy issues; nevertheless, it is important that we ask the following basic questions before we arrive at conclusions to these questions.

- 1) How important is the issue to U.S. interests?
- 2) How does the issue relate to broader U.S. strategic interests with China?
- 3) How much leverage does the United States have over the PRC on the particular dispute?
- 4) Does the U.S. enjoy the support of its allies?

- 5) How sensitive is the issue to the PRC and those contenders for political power in the present transition from the Deng Xiao Ping era and what is likely to be their reaction?

Today, we are extremely fortunate to have the Honorable Charlene Barshefsky, Deputy U.S. Trade Representative and lead negotiator of the U.S.-Sino IPR agreement, and Acting-Assistant Secretary for East Asian and Pacific Affairs, the Honorable Peter Tomsen, to discuss both the details of the intellectual property rights agreement and its implications for future U.S.-Sino commercial relations. Ms. Barshefsky has just returned from these very important IPR negotiations and we are grateful she could testify so soon after her return. Similarly, Assistant Secretary Tomsen recently briefed our subcommittee on U.S. overall relations with China and we are fortunate to have his broad perspective on these important issues.

After our first panel, we will look forward to hearing from two distinguished private witnesses: The Honorable Beau Boulter, former Congressman from Texas and an author of the article, "President Clinton's China Policy: From Human Rights to the Bottom Line," and, Dr. Robert Kapp, President of the U.S.-China Business Council. The Council represents more than 280 American corporations with substantial trade and investment interests in China.

Opening Statement

Joint Subcommittee on Asia and the Pacific and IEPT

The U.S.-China IPR Agreement

Rep. Howard Berman

I'd like to begin by thanking Chairman Bereuter once again for organizing this timely hearing on extremely short notice. The ink is hardly dry on this agreement. And thank you, Deputy Secretary Barshevsky, and Mr. Tomsen, for your time today. This has been a busy week in the U.S. - China relationship, one capping negotiations which began a year and a half ago. I join a good number of people in government and the private sector in congratulating you on having prevailed through some difficult stretches.

The costs of intellectual piracy are difficult to overstate--they not only mar what has become a \$50 billion commercial relationship with China, but cut deeply into U.S. exports throughout Asia and South America, where illegally copied software and entertainment products are routinely sold. Most observers agree that after so many fruitless rounds of discussion with the Chinese, the agreement represents a genuine breakthrough.

You probably know all too well, however, that there is a great deal more work to be done. The deal struck with China late last week is but a schematic for a dramatic transformation China's leadership needs to effect in its information sector. Whether they are inclined to do so--and whether they are able to do so--are two questions that cut to the heart of our relationship with that country. Some doubt China's ability to reign in a booming illegal industry which ties government officials to underworld entrepreneurs. Nevertheless, by maintaining a consistent negotiating position--backed by the threat of a disruption of trade--we've managed to focus the attention of China's leaders and commit concerted energy to greatly needed administrative and legal reforms.

It's obvious that sticking to our guns worked in this case. Early on we defined our objectives, made them clear to our Chinese counterparts, and outlined clearly the consequences of their failure to undertake measures to end intellectual piracy. Now I wish that we could rivet their attention in the same fashion to areas that are of equal or greater concern. For example, it seems that no matter how we adapt our approach to human rights and arms control, Chinese rights violations and exports of troubling military technology continue. There is no reason why can't we keep our dialogue with the Chinese on these issues in terms that are at least as clear and simple as our discussion of intellectual property rights. After all, we

aren't asking for things such as "special enforcement periods," task forces or customs mechanisms, as in the case of the intellectual property agreement, but simply for the government of China to cease and desist from certain abhorrent or destabilizing activities. Successful engagement with China on these issues, no doubt, will require some of the same skill and consistency we've applied to intellectual piracy negotiations.

So I look forward to hearing the assessments of the agreement today from our government and private witnesses, and to exploring its usefulness as a model for resolving other outstanding issues in our relations with China.

TESTIMONY BEFORE THE
 COMMITTEE ON INTERNATIONAL RELATIONS
 SUBCOMMITTEE ON ASIA AND THE PACIFIC
 SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY AND TRADE
 AMBASSADOR CHARLENE BARSHEFSKY
 DEPUTY U.S. TRADE REPRESENTATIVE
 MARCH 2, 1995

Chairman Bereuter, Chairman Roth, it is a pleasure to appear before your subcommittees again today to bring you up to date on our recent agreement with China which will provide for strong enforcement of copyrights, trademarks, patents, trade secrets and other intellectual property rights in China. Our computer software, motion picture, sound recording, and publishing industries will also benefit from new, improved access to the Chinese market.

This agreement benefits U.S. industries that are consistent export earners from the flagrant piracy of their products, and provides increased markets for the products of U.S. workers in these industries. Through full implementation of this agreement, China will demonstrate that it can play by international rules on a matter of importance to its own development and economic interests as well as its trading partners. China will also have access to high quality products from the United States and assistance in the implementation of this agreement.

Let me just begin by expressing my appreciation for the support that the Administration has received from the members of this committee as we have negotiated with China. It was critical to our success in reaching this agreement that the Chinese government understand that there was strong support from both the Congress and the business community for remaining resolute in the face of the Chinese government's tolerance for piracy of U.S. intellectual property.

President Clinton has led this country on a historic effort to open markets and expand trade. He believes that increased trade is critical to our efforts to create jobs and raise standards of living in this country. The importance of trade to our economy and the rest of the world demands that the global trading system be based in a set of rights and responsibilities that all countries must accept. The Clinton Administration, with bipartisan support in Congress, has pursued this goal of an open and fair trading system through multilateral agreements like the Uruguay Round, regional initiatives like NAFTA, and bilateral negotiations like our current agreement with China. All of these initiatives share a common purpose of opening markets, expanding trade, creating jobs and strengthening the U.S. economy.

Messrs. Chairmen, last Sunday, February 26, we took the latest step in that effort, when the Administration announced that the United States and China had reached an agreement that will provide for both immediate and longer term improvements in

enforcement of intellectual property rights (IPR) owned by U.S. individuals and companies and market access for industries that rely on IPRs to protect their products. As President Clinton said, "This is a strong agreement for American companies and American workers...we have used every tool at our disposal to fight foreign barriers against competitive U.S. exports."

I. Major Industries Benefitting

- Computer software producers, including producers of CD-ROMs and video games, will benefit from increased action against manufacturers and retailers to eradicate piracy in China, including a ban on infringing exports and improved market access.
- Motion picture and video producers will benefit from enforcement of their copyrights, in particular against producers of pirated Laser Discs (LDs) and tapes, elimination of quotas, import licensing requirements and more transparent rules on censorship and faster implementation of censorship rules.
- Sound recording producers of compact discs (CDs) and tapes will immediately benefit by enforcement actions against CD pirate factories and enforcement against exports to third countries, the right to exploit a companies entire catalogue and other market access provisions.
- U.S. trademark owners in all categories of goods and services that must enforce rights in China and, especially companies that have well-known marks, like Del Monte, 3M, and Kellogg, will benefit from expedited and improved procedures to permit enforcement of trademarks. Protection against unfair competition, through copying of trade dress and other actions that could mislead or confuse consumers will also provide benefits for a wide range of U.S. industries that trade with China.

II. Immediate Benefits--Enforcement

- Export and import of pirated CDs, LDs, CD-ROMs and counterfeit trademark goods will be prohibited and infringements strictly punished, through:
 - intensified inspections and commitments to detain suspected goods for investigation, and authority to seize, forfeit and destroy infringing goods.
 - Establishment of a copyright and trademark recordation

system modeled on the U.S. Customs system.

- o Creation of a comprehensive enforcement mechanism that is empowered to investigate, prosecute and punish infringing activities throughout China.

This will be accomplished through:

- A State Council working conference on intellectual property rights (IPRs) that will issue directions and coordinate IPR policies.
- Establishment of sub-central (provincial, regional and local) intellectual property working conferences in at least 22 provinces, regions and major cities and special enforcement task forces.
- Cross-jurisdictional enforcement efforts will be specifically authorized, coordinated and carried out by enforcement task forces.
- Enforcement task forces in which all relevant departments, including the police and customs, will participate so that the task force has authority to search premises, preserve evidence of infringement and take action to shut down production of infringing goods, impose fines and revoke operating permits and business licenses.
- An intensified enforcement effort over the next six months with possible extensions of this time period for specific areas depending on success in eradicating infringement.
- Establishment of a copyright verification system and use of unique identifiers on CDs, LDs and CD-ROMs that will help identify infringers and ensure that only firms with permission from the copyright holder will be authorized to reproduce, import or export these products. Associations of right owners will be permitted to establish representative offices in China to assist in this verification process and engage in other activities that representative offices are permitted to undertake in China.
- Technical assistance from the United States to ensure effective implementation of these programs and mechanisms.

Short term efforts by the Enforcement Task Forces will focus on:

CDs, LDs and CD-ROMs. This will be done through:

- investigation of all factories producing CDs, LDs and CD-ROMs to determine whether they are producing authorized will be completed by July 1, 1995.
- investigation of firms engaged in distribution, leasing or public performance of audio-visual products (CDs, LDs, video tapes, motion pictures, audio tapes, video games) during the special enforcement period.
- establishment of an inventory check system at the retail level to ensure that only authorized product is being sold.
- revocation of operating permits belonging to those who infringe more than one time and revocation of business licenses for serious repeat offenders with a commitment not to grant a business license in the same field of activity for a period of three years.

Computer Software

- investigation of all entities, including public (government), private and not-for-profit entities that engage in commercial reproduction, wholesale, retail or rental of computer software.
- establishment of an inventory check system for software under which any product that is not distributed by a licensed firm will be seized and destroyed. Business licenses for dealing with computer software will be required and those firms found to deal in infringing or unauthorized product repeatedly will lose their business license for three years. Normal administrative and judicial remedies will also be available.
- All entities (including public entities) must provide resources sufficient to purchase legitimate software.

Books and other Published Material

- intensified investigation of publishing houses and revocation of business licenses of those engaged in piracy.
- verification that printers have authorization from the right holder to print the book or other material. Printing houses operating without a license will be shut down.

Trademark

- Pursuit of "model" cases to provide a deterrent effect on other counterfeiters
- Immediate access to all trademark agents operating in China, and for the purposes of enforcement, joint-ventures, wholly owned subsidiaries, and licensees in China will be permitted to act on behalf of the U.S. owner of a trademark.

To date, the Chinese have raided and closed seven factories, including the most notorious of the pirating factories, the Shenfei Laser Optical Systems Company outside of Hong Kong. Over 2 million CDs and LDs have been seized and destroyed in recent weeks. As I outlined the Chinese government will take further steps necessary to discover any other infringing factories and move against them within the next three months, seize and destroy infringing products and seize and destroy any machinery directly and predominantly used to produce infringing products.

III. Other Enforcement and Administrative Actions

- Improved access to effective administrative and judicial relief, including expeditious handling of intellectual property cases involving foreigners, the right to investigate alleged infringement and present evidence, and to request preservation of evidence of infringement while the case is pending.
- Establishment and publication of standards to govern the registration and renewal of trademarks in China, including standards on the key issues of determining likelihood of confusion, descriptiveness, rules for cancellation and opposition procedures.
- Enhanced protection against unfair competition, including abuse of trade dress, trade names and other actions that mislead the public as to the relevant goods and services.
- Exchange of information and statistics on Chinese enforcement efforts and regular consultations to discuss the adequacy of enforcement efforts. The United States will also provide information on intellectual property enforcement actions in this country.
- Enhanced training for Chinese judges, lawyers, students, government officials, and businesspersons on the nature of intellectual property and the importance of its protection.

IV. Enhanced Access to the Chinese Market

- Confirmation that China will not put in place quotas, import licensing requirements or other (non-censorship) requirements on the importation of U.S. audio visual products, including sound recordings, motion pictures and videos.
- U.S. record companies will be permitted to market their entire catalog of works in China, subject to censorship rules.
- U.S. film product companies are permitted to enter into revenue sharing agreements with Chinese companies.
- U.S. companies in the audio-visual industries will be permitted to enter into joint venture arrangements for the production and reproduction of their products in China. These joint ventures will also be able to enter into contractual arrangements immediately with Chinese publishing enterprises for the nationwide distribution, sale, display and performance of their products in China. They will now be able to establish operations in Shanghai and Guangzhou and other major cities, with the number of cities to grow to thirteen by the year 2000.
- U.S. computer software companies will also be permitted to establish joint ventures in that sector and produce and sell computer software and computer software products in China.

A Review of the Problem and a History of U.S. Efforts to Resolve It

From 1984 through 1994, U.S. yearly exports to China rose from \$3 billion to \$8.8 billion. In the same period, however, Chinese exports to the U.S. rose from \$3.1 billion to almost \$38 billion. Some of the fastest growing and most competitive industries in the United States -- and ones in which we frequently have a trade surplus -- have been adversely affected by China's failure to enforce intellectual property rights, including computer software, audiovisual products, books and periodicals and trademarked goods and services.

While China did make significant improvements in its IPR legal regime as a result of the 1992 U.S.-China Memorandum of Understanding on Intellectual Property Protection, piracy of copyrighted works and trademarks continued to be rampant because China did not live up to its obligation under the Agreement to enforce its laws and regulations. Until recently, enforcement of intellectual property rights has been virtually absent, with

piracy rates soaring in all major urban centers along China's increasingly prosperous east coast.

Piracy of computer software -- one of the most competitive industries of the United States -- has been running as high as 94 percent, according to U.S. software industries. Chinese piracy of U.S. CDs, laser discs, cassette tapes, videos and movies has been close to 100% in many parts of China.

In the past two years, Chinese companies have begun to export pirated products in large volume -- despoiling markets in southeast Asia and even reaching Latin America, Canada, and the United States. This trend is exemplified by the fact that 29 CD and LD factories in China have had a production capacity of 75 million CDs for a domestic market that can absorb only 5 million CDs annually. In addition, some of these factories began to produce and export CD-ROMS, which can hold dozens of computer software programs and other copyrighted works on a single disk. The administrative apparatus in China for policing copyright piracy has been extremely weak. Piracy of trademarks has also been rampant, especially in south China. Enforcement, while effective in some locales, has been sporadic at best.

On February 4, 1995, the Administration announced that, although the United States stood ready to continue to engage in serious negotiations, it had ordered the automatic imposition of 100% tariffs on over \$1 billion of imports of Chinese products beginning February 26 if an acceptable agreement could not be reached by that date.

Ambassador Kantor's February 4 announcement was the result of an eight month investigation under the Special 301 provision of the Trade Act of 1974 into China's intellectual property rights enforcement practices. On December 31, USTR Kantor had issued a proposed determination that China's IPR enforcement practices were unreasonable and burdened or restricted U.S. commerce and denied fair and equitable market access to U.S. IPR owners. USTR published a proposed retaliation list of \$2.8 billion and held hearings on the proposed increase on tariffs on these products. At the same time, Ambassador Kantor extended the investigation until February 4 to allow negotiators time to pursue an acceptable settlement.

Conclusion

Messrs. Chairmen, this is a good agreement for the U.S. workers and firms. It will bolster our efforts to create more high-wage jobs in some of our most competitive industries. Our legitimate, high-quality products will not be required to compete against Chinese pirated and counterfeit goods in third countries and in China. Our exports to China and third countries should increase.

It means American businesses can gain the confidence they will be fairly treated as they enter the Chinese market, one which presents immense potential for U.S. businesses.

It is also a good agreement for the Chinese. It will provide evidence that China is willing to play by the international rules and enforce them. It will also improve the investment climate and encourage access to the high quality, technologically advanced U.S. goods and services. The agreement contains key features ensuring transparency in the Chinese system, which bolsters efforts to have a more open and democratic society.

Messrs. Chairmen, it is critical that we do not rest on this Agreement alone. Equally important, we must ensure that the agreement is fully implemented and enforced. We will be working aggressively to make sure that it is.

Again, let me say that I appreciate the support and cooperation we have received from the members of these subcommittees. I look forward to working with you in the weeks and months to come as we implement and enforce this historic agreement. Thank you.

CHARLENE BARSHEFSKY

Charlene Barshefsky is a partner in the Washington, D.C. law firm of Steptoe & Johnson, where she co-chairs the firm's 35-lawyer International Practice Group. Ms. Barshefsky's practice is concentrated in international trade law and policy, with particular emphasis on: (1) the representation of domestic and foreign clients in international trade-related administrative and judicial litigation in the United States and foreign countries (antidumping, countervailing duty, escape clause, section 301, 406, and 337 cases); (2) advice and counseling to clients in connection with U.S. government export and import regulations and the development of global international trade strategies; (3) representation of clients in connection with trade policy and legislative initiatives before Congress and the Executive Branch, including bilateral and multilateral initiatives such as the Canada-U.S. Free Trade Agreement, the North American Free Trade Agreement, EC-1992, GATT negotiations, and Central and Eastern European Initiatives; and (4) representation of clients with respect to market access issues, including U.S. investment abroad, foreign investment in the United States and international public procurement laws and practices. Ms. Barshefsky has practiced in the international field at Steptoe & Johnson for 17 years. Her clients include a broad array of U.S. and foreign entities.

Ms. Barshefsky has written and lectured extensively on U.S. and foreign trade laws and policies and public procurement regimes, and has testified before congressional committees. She has been a Vice Chair of the International Law Section of the American Bar Association as well as a member of its governing Council and Chair of its Publications Committee. She has also Co-Chaired the ABA International Litigation Committee. She is on the editorial advisory boards of the European Business Law Review and the International Trade Corporate Counsel Advisor and serves on the Board of the International Legal Studies Program of the American University School of Law. Ms. Barshefsky Chairs the U.S. Court of International Trade Advisory Committee by appointment of the Chief Judge, and served as an initial roster member of the Chapter 19 Canada-U.S. Dispute Resolution Panels under the Canada-U.S. Free Trade Agreement.

Ms. Barshefsky received a B.A. degree with academic honors from the University of Wisconsin, majoring in Political Science and English, and a J.D. degree from the Catholic University School of Law, Washington, D.C., where she graduated 7th in her class and was an associate Editor of the Law Review. She is married to Edward B. Cohen, an attorney; they have two children.

Testimony for
The House International Relations Committee
Asia and Pacific Subcommittee
March 2, 1995

Peter Tomsen
Acting Assistant Secretary
East Asian and Pacific Affairs
Department of State

Introduction:

Mr. Chairman, thank you very much for the invitation to speak before the Asia Subcommittee of the House International Relations Committee. Before I begin, may I extend congratulations to Ambassador Barshefsky, Ambassador Kantor and the entire negotiating team for the firm and principled way they conducted extremely difficult negotiations which ultimately yielded an excellent IPR agreement. I am very pleased to have this opportunity to sketch out in broad terms how the IPR Agreement Ambassador Barshefsky has just described for you fits into our overall strategy of "comprehensive engagement" with China.

This Administration, and we at the State Department, are committed to working closely with you in order to shape a strong bipartisan policy that will advance our broad spectrum of interests in China.

A Diverse and Complex Relationship:

Since we established formal diplomatic relations with the People's Republic of China in 1979, the scope of our ties with the world's most populous country has expanded significantly. Two countries with international interests and influence as extensive as ours must be engaged with each other on a very broad range of issues, in the interest of long term regional and global peace and security. The IPR Agreement is the most recent demonstration of the complexity of this relationship, and its increasing importance.

Pursuing the interests of the United States is of course the fundamental premise of our China policy. We have just advanced our interests in the IPR negotiations. In trade and other areas, we must apply this yardstick in addressing the entire constellation of bilateral, regional and global concerns in which our countries' interests intersect.

Comprehensive Engagement:

It is in this context that this Administration developed and the President approved a strategy of "comprehensive engagement" with China. The purpose of this strategy can be simply stated:

- o to pursue all of our interests at the levels and intensity required to achieve results;
- o to seek to build mutual confidence and agreement in areas where our interests converge; and
- o through dialogue, to reduce the areas in which we have differences.

In short, we bear in mind that, as the President has stated, the U.S. national interest is served by maintenance of friendly relations with a China that is strong, stable, prosperous and open.

We sometimes hear sincere criticism that this policy approach can lead to apparent inconsistencies, misperceptions, and skewing of what should be our top priorities. There are those who contend with passion and conviction -- which we understand and fully respect -- that if China fails to address our concerns on a particular issue, then we should put our other interests and objectives on hold until we have seen progress.

This Administration believes, however, that in dealing with a country as large and as important as China, it is essential to continue pushing our interests forward on as many fronts as possible. In areas where the two countries' interests conflict, the going may often be slow. But there are also many areas where U.S. and Chinese interests are complementary and where constructive cooperation between us produces significant benefits for both countries, and also contributes to regional and global peace and security.

Human Rights:

Our attention is often focused, quite naturally, on areas of obvious disagreement. The human rights issue is a case in point. This Administration and the American people remain extremely concerned with China's continued failure to meet internationally-accepted standards on human rights, including norms that have been recognized by Beijing itself -- for example, in the Universal Declaration of Human Rights.

When the President decided last year to de-link human rights from MFN, he made it clear that de-linkage represented a shift in the tools we will employ to achieve progress on China human rights issues -- it did not represent a shift from the

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Administration's continued stress on human rights. This stress has been clear in Geneva, for example, where we have joined the European Union and others in a concerted effort at the U.N. Human Rights Commission to put the spotlight on China's human rights abuses.

We are likewise pressing a bilateral dialogue with China on human rights issues, addressing such areas as prisoner releases, Tibet, and visits by international humanitarian organizations to Chinese prisons. We have begun to discuss with the Chinese how we can help to strengthen legal reform efforts in China, and the establishment of a stronger judicial system. Supreme Court Justice Kennedy's recent visit to China was very helpful in this regard.

Improvement in Chinese human rights practices is an essential element of our China policy and, indeed, of our efforts to achieve a stable long-term U.S.-Chinese bilateral relationship. That is why Administration officials visiting China without exception raise our human rights concerns. And it is why aggressive attention to our human rights agenda remains a central aspect of our "comprehensive engagement" strategy.

Our Broad Goals in Economics and Trade:

Our increasingly important economic and trade relations with China are another key aspect of this "comprehensive engagement" strategy. Ambassador Barshefsky has just described for you the recent round of very tough negotiations on the protection of intellectual property rights. Just two months ago, we and many of China's other trading partners, large and small, participated in a separate, but equally grueling, talks related to China's accession to the World Trade Organization.

The IPR and WTO negotiations must also be viewed in the context of our broader strategy of "comprehensive engagement." In economics and trade, this strategy has two key elements:

- o First, we seek to fully integrate China into the global, market-based economic and trading system. China's participation in the global economy will nurture the process of economic reform and increase China's stake in the stability and prosperity of East Asia.
- o Second, we seek to expand U.S. exporters' access to the Chinese market. As China grows and develops, its needs for both goods and services imports will grow even more rapidly. This market represents a very important opportunity for U.S. firms and workers.

Clearly, the IPR Agreement contributes directly to our efforts to develop commercial opportunities for U.S. firms in China and elsewhere. In bringing China closer to international norms in this area, the IPR agreement also promotes China's eventual integration into the global, market-based economic and trade system.

The IPR agreement could also help to generate momentum for further progress on China's accession to the WTO. The negotiations demonstrated that, when all sides are determined to seek mutually acceptable solutions through serious and detailed talks, agreement is always possible. We hope that this pattern will be applied with equal success in China's WTO accession process.

The IPR agreement is a large step forward; but many other important substantive issues remain to be resolved in order to complete the WTO accession process. Here, too, much will ultimately depend on China's willingness to accept the basic obligations of the WTO system.

At the same time, we continue to pursue our "comprehensive engagement" strategy in other aspects of our economic relations with China. Recently, for example, we have concluded agreements with China on textiles and satellite launches. This year, we will be engaged again in talks on market access, civil aviation, export financing, and a variety of other commercial issues.

We also continue to expand our export promotion efforts - one of the central responsibilities of what Secretary Christopher refers to as our "America Desk" - and cooperative programs in scientific and technical fields. For example, during Secretary O'Leary's visit to China last week, we not only witnessed the signing of commercial agreements that will facilitate billions of dollars in new U.S. exports, but also established the framework for scientific, technical and economic cooperation in developing China's sustainable energy development program. Secretary Brown's visit to China last August was equally successful in helping to build long-term economic and business ties between China and the United States.

Conclusion:

Mr. Chairman, China is a large, populous, militarily powerful and economically significant country whose influence in the world cannot but increase. China's policies, attitudes and actions will impact upon a broad range of U.S. interests, including those in the political, security, non-proliferation and human rights areas, as well as in economic and commercial affairs. Managing this complex relationship will require sophistication, patience and much hard work.

We believe that the President's strategy of "comprehensive engagement" is the best way of furthering the broad range of U.S. interests in China and East Asia. We hope that our approach will enjoy broad bipartisan support in the Congress.

Thank you.

PETER TOMSEN
DEPUTY ASSISTANT SECRETARY OF STATE
BUREAU OF EAST ASIA AND PACIFIC AFFAIRS
DEPARTMENT OF STATE

Mr. Tomsen is Principal Deputy to Winston Lord, Assistant Secretary of State for East Asia and Pacific Affairs.

Mr. Tomsen entered the Foreign Service in 1967. He was Deputy Chief of Mission, American Embassy Beijing, 1986-1989. Previously, he served in the Political-Military Office, American Embassy Bangkok, 1967-1968. After a year of Vietnamese language training in Washington in early 1969, he was assigned to the USG Civilian-Military Advisory Organization in Vietnam, 1969-1970, as District Senior Adviser to an ARVN Lieutenant Colonel in the Mekong Delta. He did Consular work and was a Political Officer, American Embassy New Delhi, 1971-75; a Political Officer in the American Embassy Moscow, 1977-1978; and was a Political Officer, American Embassy Beijing, 1981-1983.

From 1984-1987, Mr. Tomsen served in the Department of State as Office Director of India, Nepal, Sri Lanka, Bhutan and the Maldives. Mr. Tomsen speaks Chinese, Hindi-Urdu, Vietnamese and Nepali.

On June 5, 1989, then President Bush accorded the personal rank of Ambassador to Mr. Tomsen, a Career Member of the Senior Foreign Service, Class of Minister-Counselor, in his capacity as the Special Envoy to the Afghan Resistance. He served as Special Envoy until January, 1993.

Mr. Tomsen has been awarded the Department's Meritorious and Superior Honor Awards, and three Presidential Meritorious Service Awards.

Mr. Tomsen was born November 19, 1940 in Cleveland, Ohio. He was graduated from Wittenberg University (B.A., 1962) and received a Master's Degree from the University of Pittsburgh in 1964. He served in the Peace Corps in Nepal, 1964-1966. Mr. Tomsen is married and has two children.

Statement by
Beau Boulter

Before the
House International Relations Subcommittees on
Asia and the Pacific
and
International Economic Policy and Trade

March 2, 1995

It is a privilege for me to testify before this joint committee on the heels of an historic trade agreement between the United States and the People's Republic of China. The significance of China's undertakings in this agreement can hardly be exaggerated, presuming, as I do, that China will live up to its obligations as expressed in the agreement. Likewise, the negative consequences of the threatened sanctions and retaliation, had they occurred, for China and our country would also be hard to calculate or exaggerate.

Of course, we should not expect that perfect enforcement and compliance will be achieved overnight, and the durability of the Chinese commitments in the agreement is not something we should take for granted. But we don't have to, for unlike the flawed January 1992 Intellectual Property Rights settlement, this one seems to have verifiable enforcement provisions in it. I for one am convinced that the Chinese would not have made this deal had they not intended to honor it. As evidence of China's good intentions, we should note that China shut down seven illegal factories, including the Shenfei Laser Factory. In fact, since the first of the year, China has systematically been destroying illegal products.

China's good faith in settling the IPR Special 301 case is also evidenced by the market access provisions in the settlement. China had been insisting that the market access issues either be settled as part of the World Trade Organization negotiations or within the bilateral market access agreement reached in October 1992. The U.S. side, however, rightly argued that a good measurement of China's sincerity to protect foreign intellectual property rights from piracy is the extent of China's willingness to open its markets to foreign information and entertainment products, since permitting open markets for information products is probably the best way to stop piracy.

As important as this agreement is for opening markets to international information products, in a broader sense, it is equally important in that it further demonstrates China's increasing openness to the world and willingness to abide by

international norms of trade

Just as now is the perfect time for China to continue to open its markets and reform its trade regime, so also is 1995 the year when Most Favored Nation status should be accorded to China on a permanent and unconditional basis and when China should be admitted into the World Trade Organization.

I. THE CASE FOR NORMAL TRADE WITH CHINA

The rest of my testimony will deal with why I think MFN should be extended unconditionally to China and why I believe that China should be admitted to the WTO by the end of the year, retroactive to January 1, 1995 so that China will have the status of a charter member.

My arguments for permanent MFN and WTO status are basically twofold, namely that I believe the record of China's progress, particularly in view of this landmark agreement, and the philosophy of the General Agreement on Tariffs and Trade itself, demand that China have normal trade relations with the U.S. and membership in WTO.

II. WORLD TRADE ORGANIZATION

One of China's top trade priorities is charter membership in the World Trade Organization (WTO). The U.S. has frustrated that goal and has been blocking China's entry. As a result, China missed its own self-imposed deadline for WTO membership of January 1, 1995.

The WTO negotiations have coincided with ongoing negotiations on implementation of the Memorandum of Understanding (MOU) entered into in October 1992 in settlement of the massive Section 301 Market Access Initiative case filed by the Bush Administration in April 1991. As all Members know, the China 301 case was the most sweeping market access investigation in the history of the U.S. Trade Representative (USTR) and was essentially aimed at reforming China's entire trade regime.

In the October 1992 MOU, China agreed to reduce or eliminate a wide variety of trade barriers over the next five years, including tariffs, quotas, import restrictions, import licenses, and import substitution laws. In addition, China agreed to make its trade regime more transparent by publishing its trade laws and regulations. For its part, the U.S. pledged to "staunchly support" China's entry into the GATT and to reduce controls on computer and telecommunications equipment exports to China. A working group was set up to monitor compliance with this important agreement.

The USTR admits that China has taken many steps to comply with most of the market access MOU and that it has largely come into compliance with the agreement. But in late 1994, U.S. negotiators were insisting on further transparency, a fully convertible currency, and stabilization of the currency exchange rates. And of course, until a few days ago, the U.S. was demanding better enforcement of China's laws protecting U.S. intellectual property rights and greater market access for intellectual property products.

The principle dispute between China and the U.S., however, in terms of WTO membership, has been over the status of China's membership. China maintains that it should be admitted as a developing nation, a status that would give it greater leeway than a developed country such as the United States to subsidize its export industries and protect its basic and infant industries. The U.S. maintains that China should be admitted to WTO on essentially the same terms as a highly industrialized nation.

This same dispute existed at the forum for Asia Pacific Economic Cooperation (APEC) in Indonesia last November. President Bill Clinton had proclaimed that APEC would be the key to his strategy to create "high wage jobs and a high growth economy" because the eighteen leaders of the Pacific Rim nations committed to "free and open trade and investment" by the year 2020.

According to the Bogor Declaration, the highly industrialized nations must get rid of all trade barriers by 2010. The lesser developed countries must do so by 2020. Clearly, countries such as Indonesia and the Philippines are lesser developed countries, but it is not clear which category the countries of South Korea, Taiwan, Hong Kong, and Singapore are in. More importantly, China adamantly emphasized its category as a lesser developed nation, while the U.S. placed China in the same category as itself, Japan and Canada.

China's President Jiang Zemin, while ostensibly backing the forum's long-term goal of trade liberalization, also insisted on going slow in order to protect China's favorite industries, saying that, "APEC should achieve that goal [of free trade in the region] on a gradual and practical basis and show respect to the diversity in economic, social and cultural backgrounds of its members."¹

That is exactly the Chinese view on WTO membership. It wants to be admitted as a lesser developed country or, at least, not as a highly industrialized nation. This difference could be glossed over at APEC, which barely qualifies even as an agreement to agree. It cannot be papered over in negotiating the status of China's membership in the WTO.

It is true, as the U.S. argues, that China has become a major force in the world

¹China Daily, November 10, 1995.

economy. It is one of the top 11 exporting nations, fourth largest exporter to the U.S. after Japan, Canada and Mexico, and the world's third largest economy, by some measurements, after the U.S. and Japan. Also, there was a \$23 billion trade deficit with China for 1993, and it is estimated to be as high as \$29.4 billion for 1994.

Still, it seems indisputable that China is as yet an extremely poor socialist country in transition and, therefore, should be admitted as a lesser developed country. To do so would be in accord with the GATT philosophy that freer trade helps all economies grow, thus minimizing the specter of economic depression, and, even more importantly, war itself. Implicit in the original idea behind GATT in 1947 was the belief that the new international economic order would allow the U.S. to increase its own wealth and power and thus to carry its values to every corner of the globe. In light of the Special 301 settlement of the IPR case, which will result in more U.S. information penetrating China, it seems more true than ever that world wide economic stability and peace will be promoted by China's inclusion into the global trade community.

Still, one may ask whether Deng Xiaoping has opened China's door wide enough for WTO membership. Putting it differently, have China's foreign trade reforms been sufficient to justify WTO membership? Even before the IPR trade agreement, China's progress in foreign trade reform had been substantial.

While recognizing that there are many legitimate complaints about China's trade regime, the record of China's progress, especially with the recent settlement, and the philosophy of GATT itself, demand China's entry into the WTO. In the interest of good relations with China and the pro-democracy movement there, as well as further trade liberalization itself, China's accession should come at least by the end of this year, and be granted on a retroactive basis.

iii. CHINA'S TRADE REFORMS

China's leaders know that continued progress in China's economic reforms and continued economic growth depend on increasing trade liberalization. As China's open door policy has progressed, the role of international trade has increased in China's economy. Whereas prior to the reforms, China's international trade system was extremely centralized and controlled by secret decisions of government officials, the economic reforms have resulted in a progressive restructuring of China's foreign trade system.

Since the economic reforms were initiated in 1979, exports have increased 900 percent and imports 700 percent. In the process, China has become a relatively open economy, with merchandise trade constituting well over 30 percent of gross domestic product (GDP), making China's economy actually more open than that of the United

States, according to the World Bank.² Import penetration is extremely high in some sectors of the economy, such as machinery and transport equipment. The United States is the second largest exporter to China after Japan.³

The central government still exercises too much control over imports, but these controls are definitely relaxing as China decentralizes its economy and continues with its macro and micro economic reforms.⁴ As far as exports are concerned, the central government has by and large stopped direct subsidization.

China still has too many tariffs, and theirs is a very complicated tariff system. Ours is also. We now have approximately 8,750 different rates in order to protect our domestic industries. The PRC cut rates on 225 separate items effective January 1, 1992, again lowered rates on 3,371 items in late 1992, and reduced rates on an additional 2,818 products at the end of 1993.⁵

Most of China's high tariffs are for the purpose of penalizing nonessential consumption and to protect its ever important textile industry, as well as others that are considered vital. Our tariffs seem to have no social policy whatsoever, except to also protect the textile and other industries. Mostly, our tariff system seems to simply reflect the lobbying efforts of American business. For example, the whole purpose of the multi-fiber arrangements (MFA) was to allow the U.S. to create a GATT- exempt non-tariff barrier to imported textiles and apparel in order to protect the U.S. textile industry.

It can actually be argued that American trade negotiators spend more effort, overall, in restricting U.S. markets rather than in opening them. They have negotiated 170 bilateral trade agreements since 1980 restricting exports to the United States. One authority has said, "U.S. trade law has turned incompetence into an entitlement, as any lagging American company has a right to seek relief from foreign competition. Foreign nations are increasingly denounced as unfair unless they take 'affirmative action' to force their businesses to buy more American products."⁶

As for non-tariff barriers (NTBs), Chinese authorities have recently announced the abolition of import substitution lists and phased elimination of import controls. There is

²China: Foreign Trade Reform, The World Bank (Washington, D.C., Feb. 1994).

³*Ibid.*

⁴Ironically, decentralization may actually delay implementation of the 1992 MOU as the central government loses control over provincial and local governments. For example, there is less transparency at the provincial and local level than at the level of the central government.

⁵China: Foreign Trade Reform, The World Bank (Washington, D.C., Feb. 1994).

⁶Bovard, James, The Fair Trade Fraud, (New York, St. Martin's Press, 1991).

still a heavy dose of NTB protection, mostly in the form of import licenses, for raw materials and products where domestic production is sufficient to meet the country's needs, such as iron, steel and textiles. Quotas are relied on to protect autos, electronics and some machinery. Import licenses, a highly opaque NTB, are being phased out in a timely manner consistent with the October 1992 Section 301 market access trade action, and this will accelerate now in the wake of the Special 301 IPR settlement.

China's position is that as much as it wants to be in the WTO, it must not risk a wave of unemployment now and needs time to phase out these tariffs and NTBs as it continues to restructure its economy and State owned enterprises (SOEs)

Essentially, the United States has taken the same position in the past as China now takes concerning the textile industry. In fact, the American textile industry fears a surge of imports if China comes into the WTO and wants some protection from that anticipated surge. The subject of textiles will definitely be a contentious round of trade negotiations in the near future.

On the issue of transparency, in an effort to satisfy the WTO negotiators and get its application for membership past the U.S., the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) has published in a central document hundreds of trade documents previously unavailable. China has agreed that only those rules, regulations, law, etc that are readily available to other governments are to be enforced.

China has even made important moves toward a convertible currency and stabilization of the currency exchange rate, though this is a very complicated issue.⁷ Even before the IPR settlement on February 26, there had been great progress since January 1992 by China in the area of protecting intellectual property rights. In fact, it has often been stated that, starting from scratch, this huge Communist-run country, struggling toward a socialist market economy, did as much in less than two decades in developing a legal system to protect intellectual property rights as industrialized nations did in a century. Of course, China benefited from the experience of others, but the point is, that for all of its shortcomings in the area of intellectual property rights, China had made great

⁷Traditionally, all exporters have been required to turn over all of their foreign exchange receipts to a specialized bank, the People's Bank of China, in exchange for domestic currency, thus depriving the exporter of all foreign exchange to finance imports. Instead, they were allocated foreign exchange quotas, just like all other importers. Thus, there has been virtually no ability of the People's Bank (the closest thing China has to a Central Bank) to intervene in the foreign exchange market to stabilize the exchange rate. This system is a carry-over from the pre-Deng days and requires major reforms in the State-owned enterprises, the banking system, and the exchange regime itself. The process is under way, and the government's goal is to unify the exchange rates and make the renminbi a fully convertible currency.

progress even before February 26 when China again demonstrated its desire to belong to the World Trade Organization by removing the issue of enforcement of intellectual property rights protection.

Successful economic reform must proceed step by step by step. This requires political stability. China has engaged in gradual, careful, sequenced reform, not all at once, start and stop. This approach has already resulted in about 80% of the employed population working outside the State-owned enterprise system, which now accounts for only about 50% of the economy.⁸ Thus, at least since June, 1989, China has been able to avoid, for the most part, the serious problems of economic, social and political chaos that, for example, Russia constantly faces.

Under Deng's economic reforms, China has become a major trading nation in rapid order -- number 10, 11, or 12, in the world, depending on who one wants to believe. If China's reforms are to succeed, and if China is to find its role in the international community of nations, it will have to recognize the legitimate concerns of its trading partners and respond to them. That is what China in fact did on February 26, 1995. It just shows how important full and original membership in WTO is to China.

Just as now is the perfect time, economically and politically, for China to press on towards genuine trade liberalization, and just as China must intensify even further its resolve to abide by the basic GATT philosophy of free consumer decision, free markets and freer trade, so also is now the time for the U.S. to abide by its commitment in the October 1992 MOU and truly support China in its efforts to achieve WTO membership. Part of that process is allowing China a degree of the flexibility it asks for in its tariff reduction schedule.

IV. MOST FAVORED NATION STATUS

To the end of helping China into the world community of economic partners, the U.S. should grant China unconditional and "permanent" Most Favored Nation status. Originally aimed at the Soviet Union, the Jackson-Vanick Amendment simply states that normal trade relations will be granted a Communist country conditioned upon free emigration rights. China received MFN status in 1979 without any controversy, and China's MFN status has never been challenged on the basis of the sole statutory condition, i.e., emigration.

After President George Bush announced renewal of MFN for China following the Tiananmen Square crackdown on June 4, 1989, candidate Bill Clinton campaigned

⁸ The State Economic and Trade Commission just announced that the rate of non-profitable SOEs in China decreased from 45% to about 33%, so even in this area where there has been very little real reform, efficiency is improving somewhat.

against Bush's policy of "coddling the tyrants in Beijing". On May 28, 1993, President Bill Clinton issued his executive order extending MFN to China to July 3, 1994, conditioned on "significant progress" in the area of human rights.

In the President's statement, he said that Americans had been outraged by the killing of pro-democracy demonstrators at Tiananmen Square in June 1989 but that when Congress expressed that outrage by placing conditions on most-favored-nation trade status with China, President Bush had twice vetoed such legislation. Mr. Clinton then discussed the evidence of Chinese missile sales to Pakistan, then turned to a discussion of the growing U.S. trade deficit with China, and concluded that in order to promote democracy in China and open China's markets, the Administration would adopt a new policy toward China:

The core of this policy will be a resolute insistence upon significant progress on human rights in China by extending most-favored-nation status for China for 12 months, but, whether I extend MFN next year, however, will depend upon whether China makes significant progress in improving its human rights record.⁹

With that statement, President Clinton adopted the congressional policy twice vetoed by President Bush and extended MFN to China conditionally, making MFN renewable on July 3, 1994 for 12 months, provided that China has made "overall significant progress" in the area of human rights. The order further committed the US government to make China abide by its commitment to fair trade practices and to adhere to the Nuclear Non-Proliferation Treaty (NPT) and the Missile Technology Control Regime (MTCR).¹⁰

Winston Lord, Assistant Secretary for East Asian and Pacific Affairs, testified before the Subcommittee on Trade of the House Ways and Means Committee on June 18, 1993, that:

We are hopeful the Chinese Government will take significant steps in the human rights area which will permit the President next year to renew the P.R.C's MFN status in a positive

⁹ Statement released by the White House, Office of the Press Secretary, Washington, DC, May 28, 1993, US Department of State Dispatch, June 14, 1993, Vol.4, No.24.

¹⁰ Executive Order-Conditions for Renewal of Most-Favored-Nation Status for the People's Republic of China in 1994, released by the White House, Office of the Press Secretary, Washington, DC, May 28, 1993, US Department of State Dispatch, June 14, 1993, Vol.4, No.24.

fashion. But the President is prepared to revoke that status if satisfactory progress does not occur.¹¹

Lord noted in his testimony that "the American business community has been effectively expressing its views to the executive and legislative branches on the issue of MFN."¹²

After all, between July 1992 and 1993, China purchased cars from the Big Three for \$314 million, concluded deals for \$6 billion with six other U.S. companies, had signed contracts for 20 Boeing aircraft worth \$600 million, and was negotiating to purchase oil equipment from Texas and leasing drilling rights in the Tarim Basin.

Secretary Lord added, "We hope, however, that it will also express to the Chinese concerns that Americans have on humanitarian and other issues."¹³

Clearly, China did not make, nor has it made, any substantive changes in its human rights policy. Yet, on May 26, 1994, President Clinton totally reversed his policy and unconditionally renewed MFN for China by his executive order of July 3, 1994, thereby separating human rights from the issue of normal trade relations with China

Precisely for the sake of human rights and notwithstanding evidence to the contrary, I believe that the President was correct to reverse his policy and separate China's trade status from human rights policy. My opinion is based on working with the Chinese dissident and pro-democracy community, both on mainland China and in the U.S. It has been rare for me to talk with someone in this movement who does not want permanent MFN for China. They believe that normal trade is the very oxygen of the pro-democracy movement.

It would be a tragedy for this Congress to revert back to the Congressional leadership position as it was from June 1989 until May, 1993 when President Clinton adopted congressional policy. After all, he wisely reversed his decision, and very forthrightly at that.

On May 26, 1994, when the President announced unconditional renewal of MFN for China, he candidly stated:

I have decided that the United States should renew Most Favored Nation trading status toward China. This decision,

¹¹ US Department of State Dispatch, June 14, 1993, Vol.4, No.24

¹² *Ibid.*, at 4.

¹³ *Ibid.*

I believe, offers us the best opportunity to lay the basis for long-term sustainable progress in human rights, and for the advancement of our other interests with China. . . .

I am moving, therefore, to delink human rights from the annual extension of Most Favored Nation trading status for China. That linkage has been constructive during the past year. But I believe, based on our aggressive contacts with the Chinese in the past several months, that we have reached the end of the usefulness of that policy, and it is time to take a new path toward the achievement of our constant objectives. We need to place our relationship into a larger and more productive framework.

* * *

I believe the question, therefore, is not whether we continue to support human rights in China, but how we can best support human rights in China and advance our other very significant issues and interests. I believe we can do it by engaging the Chinese. . . . We will have more contacts. We will have more trade. We will have more international cooperation. We will have more intense and constant dialogue on human rights issues.¹⁴

Though I do not think the President's original policy on MFN was helpful to the cause of human rights in China, I do appreciate his well stated reasons for reversal. He might have said that China had made significant progress in the area of human rights and declared victory. That would not have been true, however.

Congress must not reestablish linkage. Linkage was a bad idea to begin with. It would be worse now, after China has come this far in its economic reforms and after it has opened up to the rest of the world as much as it has done. It would be especially disastrous to link MFN to human rights progress during the succession period. The fact is that human rights progress in China will be furthered in a climate of economic progress rather than economic regression, stagnation, or depression.

All of America's goals will be better advanced if MFN is not only kept separate from human rights considerations, but if MFN is granted to China without Jackson-Vanick annual conditionality. These American goals specifically include human rights, democracy

¹⁴Press conference of the President, Office of the Press Secretary, The White House, May 26, 1994.

in China, a vibrant trade relationship, security arrangements in the region, and nonproliferation of weapons of mass destruction.

It is possible, after all, that freer trade, especially in the area of information, will foster the emergence of entrepreneurs and intellectuals such as has happened in South Korea, Thailand and Taiwan.

Thus, President Clinton's overall strategy of commercial engagement with China is correct, though sometimes it has the appearance of mercantilism and leaves the impression that our foreign policy is too often dictated by narrow business interests. That should not be, and hopefully will not be, the case.

v. CONCLUSION

Deng Xiaoping has increased the income of the poor people, especially farmers, but also factory workers, bankers, managers and the middle class. He has used this progress to create allies among the major socio-economic sectors of the nation. He has also convinced the policy makers that economic reform is the future. Now, his disciples are using an open door policy to gain acceptance with the outside world.

The succession of Deng will undoubtedly be a severe test on the reform movement, as Jiang Zemin and his potential rivals feel the need to keep the lid on political dissent and not lose any face to the United States. Until the succession question is resolved with a degree of certainty, it would be very unwise for this country to take any action, either on the trade or human rights front, which would precipitate a hardening of position on the part of the Chinese leaders.

GATT and the WTO rely on the western neo-classic model of economics and geopolitics arising out of the Great Depression and two world wars as expressed at Bretton Woods. GATT/WTO assumes the MFN principle, and further assumes that free markets, free trade, and private ownership constitute the most productive economic system and will promote world peace.

President Clinton is not wrong to insist that China abide by free trading rules, and it appears that the IPR Special 301 initiative turned out well. Nonetheless, the administration should recognize that it is too much to expect China to immediately conform to the same set of rules the U.S. agrees to for WTO membership. The U.S. should accede to China's demand for flexibility and agree to phase in the rules over the next few years.

Having put economics, and hopefully security arrangements, rather than human rights, at the center of America's foreign policy toward China, the U.S. must recognize its challenge to invigorate the spirit of private enterprise and entrepreneurship in China. Probably, though not necessarily, such economic changes will continue to produce

political changes toward free elections.

The New World Order will be built on economics and trade, rather than traditional foreign policy. It will be built on capitalism. In this new economic order, East Asia in general, and China in particular, are on the rise. This fact accentuates the need for good U.S.-Sino relations and also the need for a genuine regional security framework, which certainly does not yet exist in East Asia, especially Northeast Asia.

China's rise will be tumultuous at times. The United States needs to be a partner in the process. It is in our interests economically and militarily. The best way to be a good partner is through economic cooperation, not economic confrontation. The IPR process was not quite confrontation in the worst sense, but it came close. Trade sanctions such as those threatened by both sides would have been a geopolitical mistake of the first order.

Normal trading status, including unconditional MFN, and charter membership in WTO (even though granted retroactively) are important for China. These are important not just for the government, but for the people as well. They are especially important to the very people who are fighting for, and depending on, both economic and political reform. Their future depends almost as much on United States' trade policy toward China as it does on their own government's economic and trade policy. America's own well-being is inextricably linked to the furtherance of China's reforms. These two truths demand sober reflection and must serve as guideposts in future trade negotiations with China.

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In the Spring of 1994, he was a resident fellow at the Institute of Politics, John F. Kennedy School of Government, Harvard University where he taught a study group on international trade and U.S. foreign economic policy. In the winter of 1994, he lectured on U.S. trade and economic policy toward China at the International College of Business, Nanjing University, The Johns Hopkins University-Nanjing University Center for Chinese and American Studies, Nanjing, and the National School of Administration, People's Republic of China, Beijing.

He currently serves as an adviser to the National School of Administration.

Testimony of Robert A. Kapp, President, United States-China Business Council, before the House Committee on International Relations, Subcommittee on Asia and the Pacific, March 2, 1995.

Chairman Bereuter, members of the Subcommittee:

I appreciate very much your invitation to appear today at this important hearing -- one of the earliest to occur in the 104th Congress -- examining U.S.-China trade and economic relations.

My name is Robert A. Kapp. Since April 1994, I have served as president of the United States-China Business Council. From 1987 to 1994, I was president of the Washington Council on International Trade in the state of Washington, and from 1979 to 1987 I served as Executive Director of the Washington State China Relations Council. Between 1970 and 1980 I served on the faculties of Rice University in Houston and the University of Washington in Seattle, teaching the history of modern China and U.S.-China relations.

The US-China Business Council, headquartered in Washington, D.C., is the foremost organization of U.S. firms large and small engaged with the People's Republic of China. Founded in 1973 as the National Council for U.S.-China Trade and renamed the US-China Business Council several years ago in recognition of the fact that our country's economic engagements with China had grown far beyond simple export-import trade relations, the Council today is supported by nearly three hundred leading American firms, including many of the best-established and most experienced companies in U.S.-China business. Completely non-governmental, non-profit, and non-partisan, the Council is funded by membership fees and by income associated with its principal publication, **The China Business Review**, which is without question the leading American publication in its field. I have taken the liberty of bringing a few recent issues of the **Review** today to offer to members of the Subcommittee or their staffs, and hope to make the **Review** available to interested members on a regular basis.

The US-China Business Council has long enjoyed close and productive interaction with key agencies in the U.S. government and key committees of the Congress. We are eager to maintain and enhance that communication with the 104th Congress, and for that reason are particularly appreciative of your decision to invite my participation in today's hearing. As I have often remarked to U.S. business audiences, unless one chooses to be a smuggler, one's private-sector international business activities rest on a framework of policies established by governments -- our own, those of the nations with whom we trade, and those of many nations acting in concert through multilateral organizations. Thus it is imperative that policy-makers be as fully informed as possible with regard to the implications of policy alternatives for those whose interests the policies will most directly affect, and it is equally vital that those in the private sector toward whose activities the policy-makers' attention is directed be regularly and strongly informed about developments in the policy field. That linking function, along with direct advisory services to our members and a variety of programmatic activities for our participating firms, is a key reason for the existence of the US-China Business Council.

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I am inserting into the record, with your permission, Mr. Chairman, a few pages of data, in tabular and graphic form, portraying the shape of U.S.-China trade and economic relations in 1994, as developed by our Council. While I welcome questions from members of the Subcommittee on the specifics of U.S.-China trade and economic relations, I hope that these submissions make it unnecessary for me to rehearse these facts and figures at length in my oral testimony.

Mr. Chairman, you have convened today's hearing with maximum speed in the aftermath of the conclusion of the recent U.S.-China negotiations over intellectual property protection -- with such speed, in fact, that the full English and Chinese-language texts of the Agreement reached in Beijing by Deputy U.S. Trade Representative Charlene Barshefsky and Minister of Foreign Trade and Economic Cooperation Wu Yi February 26 are not yet in hand. I have therefore looked forward with strong interest to the testimony offered by Administration representatives to this afternoon's hearing,

In crafting my own remarks, I have had only the Summary and press release of the Office of the U.S. Trade Representative, made available at the time of Ambassador Kantor's announcement of the February 26 agreement, on which to form my understanding of what has been achieved. It is clear from this release that the U.S. and Chinese negotiators have achieved significant progress, not only in averting the imposition of U.S. trade sanctions against China and the likely Chinese imposition of retaliatory sanctions against the U.S. imports, but in significantly improving the Chinese environment for intellectual property. Our Council looks forward to an opportunity in the near future to review and analyze the full texts of the Agreement, not only the English version which will define what American business sees in the agreement, but the Chinese version which will determine what China finds in it.

Because the February 26 intellectual property agreement is so freshly hatched, and because this hearing is effectively the first of the new Congress to focus on U.S.-China trade and economic relations, I wish to make use of my remaining time today to offer a few reflections, not only on the implications of the recent intellectual property negotiations, but on the overall atmosphere of U.S.-China trade issues, in the hopes that members of the Subcommittee who will be concerning themselves with U.S.-China relations might find them useful over the longer term.

I. Trade disputes, inevitable among major trade partners, are best handled when managed within the structures of trade-dispute resolution, and not casually intermingled with other issues.

As acrimonious as the recent IPR dispute with China at times became, its successful negotiation resulted in significant measure from willingness on the part of both nations to keep the argument within bounds. Despite frequent media references to "Trade War," the two sides in their public pronouncements (and apparently in their confidential negotiations as well) kept the focus firmly

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on the intellectual property issues at hand. The projected sanctions mentioned by both sides also reflected the finite and focused nature of the dispute, no matter how broad the significance of intellectual property issues to overall U.S.-China trade relations might be. Most important, the confining of the dispute to the essential, trade-related issues of intellectual property protection and market access permitted the negotiators to come finally to an agreement on these key questions. Agreement would have been infinitely more difficult, and probably impossible, if the original intellectual property dispute had become diluted by the introduction of unconnected trade-related issues or of non-trade issues.

In short, trade disputes between the U.S. and China, while never pleasant, need to be recognized as the virtually inevitable result of rapidly expanding commerce between two huge economies of disparate orientations. The recent IPR dispute, in fact, arose in part from progress already made between our two countries; US dissatisfaction with the inadequate enforcement of China's intellectual property regime nonetheless implied the presence of an intellectual property system which had been totally lacking in Chinese law and regulation until only a few years ago and which came into existence in part as a result of earlier debates between our two countries. U.S.-China trade disputes are, in a word, normal. We will see more of them, as trade and economic relations between our nations grow, China proceeds with its huge and historic economic transformation, and China's integration into the global economy progresses. They require of both sides a high degree of technical competence, intestinal fortitude, and ability to remain focused. They require that the U.S. know its own mind. On occasion they will require forceful prosecution, as was the case last month in the IPR dispute. They are not, in and of themselves, however, the catastrophic unravelling of U.S.-China relations, and both sides need to act in such a way as to prevent them from becoming so.

II. A key lesson of the recent IPR negotiations and agreement is that enhanced U.S.-China commercial engagement can make an important contribution to the further development of the much-talked about "rule of law" in China.

Leaving aside the obvious fact that we in the United States have our own debates over the proper extent and the effective administration of law in our own country -- the historic debates now taking place in Congress are the clearest testimony to that -- it is no secret to anyone with an hour's interest in China that Chinese and American traditions differ widely as to the role of impartial legal institutions in society. The fact -- often lamented in China as well as criticized in the U.S. -- that China relies to a great extent on "rule by men" /i.e., governance by individual power-holders through networks of personal relationships/ rather than "rule by law" -- has been observed and understood since the beginning of modern Sino-Western relations in the 17th century. Contemporary American observers frequently point out that the absence of all-pervasive and impartial legal structures in China -- of the kind we associate with the ideal of a "blind justice" -- works to the disadvantage of American business in China, and flies in the face of some of this country's most cherished ethical ideals.

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A glance at the summary of the February 26 agreement reached in Beijing should make crystal clear that expanding U.S.-China trade can and does play a real role in encouraging the gradual extension of stable legal procedures and protections, such as we know and value in this country, to a society where many of these concepts and procedures remain unfamiliar.

We have to recognize that sometimes Americans' broadest hopes are better realized as byproducts of less grandiose ambitions. In the case at hand, the U.S. proceeded vigorously to negotiate improvements in China's treatment of intellectual property rights and of foreign business rights within China. The U.S. position did not demand some broad and idealized establishment of the "rule of law," however nice that would have sounded at home. The Chinese, like any nation embroiled in a tense international trade conflict (the U.S. has been in a similar position on many occasions), presumably had to balance the importance of continued strong trade relations with the U.S. against the perceived intrusiveness of the U.S. demands into China's domestic economic affairs and even the perceived invasion of China's sovereignty.

The end result appears to be a significant expansion of the Chinese government's international commitments to the furtherance of the very "rule of law" within Chinese society that many American critics have demanded. The conclusion that I offer to you, Mr. Chairman, is that expanded trade and business activity, with its global requirements of stable, predictable and even universally-applicable law, has once again played a useful role in the realization, however indirect, of a deeply-cherished American ideal. To put it bluntly, those who argue that the American commercial engagement with China is irrelevant to, or even obstructive of, the emergence of the "rule of law" in China have stood the issue on its head, and have missed the vital point that greater commercial intercourse is powerfully conducive to the further establishment of the "rule of law" in China.

III. Media treatment of U.S.-China relations in general, and of U.S.-China trade relations in particular, tends to focus on conflict and to emphasize the spectacular, while de-emphasizing the quieter and more constructive daily accomplishments in U.S.-China business.

This is an obvious point, but I raise it because of the importance of the U.S. domestic media in informing public opinion and thus in affecting the making of U.S. policy.

The news media, to be successful, must report news; stories must be new, and they must be gripping. For TV, they must be visually compelling. News reports must have a "peg," or "hook" if they are to find a place in the mass media.

Thus, conflict generally plays better than harmony. And specific moments in a conflict -- the announcement of deadlines, the issuance of sanctions lists, and so forth -- command the greatest news attention. Generally speaking, unresolved conflicts, punctuated by high-visibility moments, receive more intense media attention than do conflict resolutions.

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I was struck by this during the recent IPR dispute. From late January, just before Ambassador Kantor's February 4 announcement of a final deadline and a final list U.S. sanctions, U.S. and international media smothered my Council with interviews and TV appearances. "Trade war" -- a term whose precise meaning was never explored -- was on every interviewer's tongue. In a month, I personally participated in at least thirty TV, radio, and print media interviews, both domestic and international.

It has been revealing to notice that, since the announcement of the major IPR agreement on February 26, I have been called on for one media interview -- from Radio Australia.

The resolution of this latest IPR conflict, and, ahead of us, the slow process of implementing it and measuring its effect -- that is news, one might think. But the reality of the news business seems to demand otherwise. We will find, I believe, that intellectual property issues in China drop from the media radar screen unless and until a new crisis develops.

The point is obvious: making effective U.S. trade policy and maintaining valuable trade relations with China depends as much on understanding their long-term structural dimensions as on responding to media output, with its completely understandable need to focus on vivid and conflict-oriented aspects of U.S.-China commercial and economic encounters.

IV. Implementation of the new IPR agreement will require U.S. vigilance. The possibility of future disagreements in the IPR field cannot be ruled out.

Serious observers of the IPR situation in China correctly remarked, during the recent crisis, that although certain immediate actions and high-visibility gestures such as raids on factories or confiscations of infringing products might be salutary, the real solutions of necessity lay in the long-term and progressive introduction to China of new and unfamiliar forms of behavior and the more effective enforcement of new and unfamiliar laws. To the credit of the negotiators on both sides, the February 26 Agreement appears to concentrate heavily on pledges of future accomplishments. Fully realized, these achievements will represent historic milestones, not only in the development of stronger U.S.-China economic and commercial relations, but in China's continued progress toward full integration into the global trading system.

Nevertheless, we can expect additional discussions and even disagreements.

Even in one language, as Members of Congress know best of all, the terms of a law are subject to interpretation, debate, and sometimes to reinterpretation. In an international document whose English- and Chinese-language versions are equally effective, the possibilities of ambiguity and of future dispute are nearly unavoidable.

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This is not the place for a long lecture on the daunting task of "perfect" translation between English and Chinese; suffice it to say that absolute unanimity of understanding of the meaning of such documents, across the language lines, is difficult to say the least. The parties to the agreement, after all, represented conflicting interests and views. While the great importance of this agreement is the achievement of a set of mutually-acceptable terms defining mutually-acceptable conduct, it is to be expected that one side or the other in the future will find cause for dissatisfaction, either with the agreement itself or with the other side's conduct under the terms of the agreement.

The United States must be vigilant, and resolute in its determination that the agreement be upheld. But we should not be unduly surprised if, at some future point, issues of "misunderstanding" arise. While the possibility of intentional evasion always exists, so do the possibilities of genuine differences of interpretation, many of them rooted in language.

The achievement of a major pact such as the February 26 intellectual property agreement represents both the immediate resolution of an intense dispute and the opening of a new chapter in an ongoing relationship. American business, American trade officials, and American lawmakers must continue to work together to achieve that steadfastness of purpose, fullness of information, and appropriateness of law and policy on which continued successful trade and economic relations between the United States and China will depend.



The United States-China Business Council

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ROBERT A. KAPP

On April 1, 1994, Robert A. Kapp assumed the presidency of the U.S.-China Business Council, the principal organization of American businesses engaged with the People's Republic of China. Since 1987, he had been president of the Washington Council on International Trade, a member-supported private organization primarily concerned with trade policy issues. At the time of his move to the U.S.-China Business Council, he was serving concurrently as Executive Director of the Washington State China Relations Council in Seattle.

In 1979, Dr. Kapp became the founding Executive Director of the Washington State China Relations Council, a private nonprofit organization established to foster commercial and cultural relations between the state of Washington and the People's Republic of China. He served in that post until moving to the Washington Council on International Trade in 1987. Under an agreement between the Washington Council on International Trade and the Washington State China Relations Council in early March, 1992, Dr. Kapp administered the China Relations Council's affairs as its Executive Director while continuing his presidency of the Trade Council.

Dr. Kapp graduated from Swarthmore College and received his Master's and doctoral degrees from Yale. His advanced training was in East Asian Studies and History, and from 1970 to 1980 he taught modern Chinese history at Rice University and the University of Washington. In 1975-76, Dr. Kapp was Visiting Scholar in the Faculty of Laws at Keio University, Tokyo. From 1978 to 1980 he served as editor of the principal U.S. scholarly journal on Asia, The Journal of Asian Studies. From 1986 to 1991, Dr. Kapp was Lecturer at the University of Washington School of Business Administration, where he taught a graduate course on trade with the People's Republic of China. He received a teaching award from the Business School in the spring of 1990. In 1992, Dr. Kapp participated in a project on U.S. China Policy under the auspices of The Atlantic Council and the National Committee on U.S.-China Relations, and in a Study Project on Trade and the Environment under the auspices of The Council on Foreign Relations.

From 1990 through 1993, Dr. Kapp as president of the Washington Council on International Trade played a leading role in carrying out non-governmental supporting activities in conjunction with the APEC Ministerial Meetings, which convened in Seattle in November, 1993.

Dr. Kapp is a member of the Council on Foreign Relations, the National Committee on U.S.-China Relations, the Contemporary Affairs Committee of the Asia Society, the U.S. National Committee for Pacific Economic Cooperation (US-PECC), and the Advisory Council of the Korea Economic Institute. He and his wife Catherine live in the Washington D.C. area with their daughter.

Ambassador Barshefsky's Testimony
to the Committee on International Relations,
Subcommittee on Asia and the Pacific
March 2, 1995

In response to Mr. Brownback's question related to the resources devoted to the enforcement of the IPR agreement:

Obviously, critical to the success of the IPR agreement is ensuring that China devotes the resources necessary to implement fully the agreement. China has made the commitment to do so. During Ambassador Kantor's recent visit to China, State Councillor Song Jian claimed that over a million people -- judges, police, customs officials and so on -- are currently assigned to enforcing intellectual property rights. The devotion of resources to enforcing IPR will be a key topic during our quarterly consultations on China's implementation of the agreement.

The Chinese committed in the agreement to increasing the resources -- both financial and personnel -- for the enforcement of intellectual property rights. China has, for example, created under the State Council a system of IPR working conferences where all IPR-related agencies, including the Customs and policy, are represented. In addition, China begun to establish enforcement task forces and ad hoc task forces to address IPR enforcement in the provinces. Again, all the relevant agencies will participate in these task forces. The Chinese Customs has also committed to increasing enforcement at the border -- a responsibility borne by the Customs as a whole. China's prosecutors and judges will also play an important role in prosecuting cases against violators.

In response to Mr. Faleomavaega's questions on the losses incurred by U.S. companies worldwide from IPR piracy:

It is near to impossible to calculate the exact amount of losses our companies are suffering from IPR piracy worldwide. To cite an illustrative example, however, the copyright industries estimate their world-wide losses to piracy to have been over \$8.6 billion in 1994. In China alone, our companies estimate they suffered \$866 million in losses last year. These industries include computer software, sound recordings, and motion pictures. While data on 1994 losses from trademark, patent, semiconductor layout design and other types of intellectual property piracy are not available, I expect that they parallel the large estimated losses in the copyright area.

As China implements the provisions of the recently concluded IPR agreement, the high level of piracy should drop. Key to this, as with any other agreement, is full implementation. One of our top priorities is working with China, and other countries, to ensure that they fully implement their agreements with us and protect U.S. intellectual property rights.



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